

Long-Short Quarterly Report – September 2018

Portfolio Performance

As at 30 Sep 2018	3mth	6mth	1yr	2yr p.a.	Net Return S/I p.a.	Total Net Return S/I
Alleron Long-Short*	-1.91%	8.35%	18.37%	17.65%	20.72%	52.78%
S&P/ASX 100 Acc**	1.55%	10.13%	13.32%	11.51%	12.53%	30.43%
Out/(under) performance	-3.46%	-1.77%	5.05%	6.13%	8.20%	22.36%

Performance figures are net of fees and expenses

*Inception date is 1 July 2016

** Performance benchmark

Portfolio Commentary

After a strong start to the year, the portfolio was more subdued in the September quarter. The Fund has outperformed the ASX 100 index by over 4% since the beginning of 2018, taking the return after fees since inception to 20.72% per annum.

The Australian market underperformed global markets in the September quarter as the US started a trade war with China by placing tariffs on US\$250bn worth of Chinese imports. Resources underperformed as tariffs threatened to slow Chinese growth while Financials underperformed as hearings on the Royal Commission into bank misconduct progressed.

The Long side of Alleron's portfolio was mainly driven by a rise in Technology stocks. Altium's strong subscriber growth and early success of recent acquisitions and product launches were well received by the market during reporting season. Xero announced a US\$300m convertible notes offering to fund strategic complementary future acquisitions. Exposure to aged care through Japara Healthcare meant the Long portfolio suffered towards the end of the quarter from the announcement of the impending Royal Commission. We note that Japara has consistently received positive accreditation by the responsible Federal agency since listing, unlike other aged care operators.

The Short side of the portfolio detracted from performance as Telecommunications stocks rebounded off lows. A merger of equals between TPG Telecom and Vodafone led the market to believe price competition would ease despite TPG CEO's reputation for taking market share through lower prices. Domino's Pizza rebounded on news of a good start to FY19 in Japan store sales and immaterial underpayment of franchisee employees. Brambles reported strong growth in Europe to offset slowing pallet sales in the Americas division.

Portfolio Highlights

Positives:

Altium Ltd (Long) – The FY18 result showed strong progress towards the Company's FY20 goal of US\$200m revenue and 35% EBITDA margins. Management has added a 2025 goal of a position of market dominance, targeting 100,000 subscribers and 40% market share.

QBE Insurance Group Ltd (Long) – After a successful company-wide strategic review, management's turnaround plan has shown early signs of progress, aided by the industry tailwinds of US interest rate hikes and rising insurance premiums.

Resmed Inc (Long) – The Company's 4Q18 result highlighted the success and increasing operating leverage of its recent connected health acquisition, Brightree, in addition to consistent double digit growth in its core sleep apnea products.

Negatives:

Telstra Ltd (Short) – The share price rose as the Company met severely reduced expectations for FY18 earnings in addition to the market believing a merger of 2 smaller competitors would lessen competition.

Japara Healthcare Ltd (Long) – The share price fell after the announcement of a Royal Commission into Aged Care Quality and Safety by Australia's new Prime Minister. The entire sector has come under pressure recently from media reports of alleged mistreatment of aged care facility residents.

Elders Ltd (Long) – The share price fell on growing concerns the long-standing drought in Australia will continue to negatively impact the sale of agricultural retail products.

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%
2018/19	-1.09%	1.45%	-2.24%										-1.91%



Market Overview

The Australian market had a volatile quarter as the US-China trade war started and severe typhoons destroyed parts of Asia and US in late September. Technology and Healthcare stocks outperformed during reporting season while Energy stocks followed the oil price higher towards the end of the quarter. Cochlear announced it has sold 550,000 implants since inception and forecasted double digit profit growth. Treasury Wines result reported nearly 300% French wine growth in Asia. Wesfarmers announced sales of non-core assets while its Bunnings division continued with double digit growth.

Portfolio Changes

Increased Exposure:

CSL Ltd (+4.50%; New Long): A global blood products and vaccines company. The core Immunoglobulin and Specialty products have continued their high double digit growth rate and the recently acquired Seqirus vaccines business has been successfully turned around to reach profitability.

Computershare Ltd (+3.00%; Long): A share registry and mortgage services company. A recent complementary acquisition in Employee Share Plans, operating leverage fueling strong growth in Mortgage Services and rising interest rates have all contributed to growth momentum.

QBE Insurance Group Ltd (+3.00%; Long): A general insurance company. Coupled with industry tail winds of rising interest rates and rising insurance premiums, the CEO's turnaround plan has shown promising signs of early success.

Decreased Exposure:

Japara Healthcare Ltd (-3.75%; Exit Long): An Australian aged care owner and operator. The Federal Government's announcement for a Royal Commission into Aged Care Quality and Safety has increased uncertainty for the entire sector.

Iluka Resources Ltd (-3.00%; Exit Long): A mineral sands and zircon producer. Despite the Company announcing increased zircon pricing, future production costs have been forecast to increase in the next half with rising Indonesian swing production adding to profit headwinds.

Seek Ltd (-4.50%; Long): An online job advertisement platform operator. Management's long term reinvestment plan to consolidate its market leading position in each of its territories have resulted in guidance for a flat profit for FY19.

Quarter-End Position & Portfolio Exposures

As at 30 September 2018, the fund had a net exposure of 95.15% and gross exposure of 196.35% to equities. Cash was 4.80%.

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

Stock Highlight

NextDC Limited (NXT) – Long Position

Energy Argument: NextDC listed on the ASX as the only listed company purely focussed on developing and operating high quality data centres in Australia. Indeed, at the time of listing, the company had only a plan to refurbish an existing owned building in Brisbane and a development site in Melbourne into two data centres. Data centres are used to house centralised corporate IT infrastructure that can be used anywhere via internet connection also known also as cloud computing. Alleron was very interested in this business as a result of the rapid increase globally in software delivered via cloud and the number of large Australian corporates utilising this centralised infrastructure for their internal IT operations. By 2016, NextDC had grown to 4 data centres and had become EBITDA positive.

Trigger: In 2016, NextDC results confirmed that the company was successfully implementing its strategy and signing up some of the world's largest companies as clients and was quickly filling its capacity. In late 2016, the Company raised \$150m in equity capital to accelerate its capacity growth and almost triple its potential capacity to 120MW. This change in growth profile, indicated by the completion of funding and confirmation of earnings outlook at the AGM in November 2016, provided the trigger for Alleron to invest at \$3.16 per share.

Outlook: Since the initial investment, NextDC has continued to rapidly fill its installed capacity with premium clients. In April 2018 they raised a further \$900m in equity and debt capital to again accelerate capacity growth to about 310MW. Should the company continue to execute as they have proven to have done over the last 8 years, Alleron believes that EBITDA at full utilisation of planned capacity could be up to 10X current EBITDA hence providing significant upside to its market valuation.





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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