Australian Eagle Asset Management

Long-Short Quarterly Report – December 2019
FOR WHOLESALE INVESTORS ONLY

Portfolio Performance

As at 31 Dec 2019	3mth	6mth	1yr	2yr p.a.	3yr p.a.	Net Return S/I p.a.	Total Net Return S/I
Aust. Eagle Long-Short*	**1.60%**	**2.87%**	**29.80%**	**15.82%**	**17.61%**	**19.45%**	**86.30%**
S&P/ASX 100 Acc**	0.70%	3.20%	24.06%	10.07%	10.40%	12.13%	49.30%
Out/(under) performance	0.89%	-0.33%	5.74%	5.74%	7.21%	7.32%	37.01%

Performance figures are net of fees and expenses
*Inception date 1 July 2016
** Performance benchmark

Portfolio Commentary

The Portfolio returned +1.60% after fees for the December quarter. The return for CY2019 was +29.80%, outperforming the ASX 100 accumulation index by +5.74%. The Fund has also maintained positive outperformance over the longer term with +7.32% p.a. outperformance since inception.

The Australian market underperformed world markets in the December quarter as markets moved positively to news of a phase 1 US-China trade deal with yield curves steepening in reaction to the news. Boris Johnson called and won a snap election to continue as the UK Prime Minister. Social unrest in Hong Kong and Chile offset investor optimism about a global economic recovery. China announced further monetary policy easing and fiscal stimulus to maintain GDP growth above 6%.

The Long side of the Portfolio contributed positively to performance as iron ore miners continued their rise towards the calendar year end, boosted by elevated iron ore prices. Healthcare stocks also rose with CSL benefiting from media focus on a $800m research project for a new preventative heart attack drug. ResMed's quarterly report revealed double digit growth in all divisions with a gross margin increase attributed to a strong contribution from its cloud business. Technology stocks contributed to performance with Xero reporting strong UK subscriber growth and EBITDA growing by almost 100%. Pushpay acquired a highly complementary church management system which will provide a more complete product offering to customers.

The Short side of the Portfolio detracted from performance as the re-election of Boris Johnson negatively affected the portfolio stocks with UK exposure, namely Virgin Money UK and Computershare. Caltex received a $8.6bn takeover bid from a Canadian petrol and convenience operator. Whitehaven Coal downgraded FY20 guidance due to production stoppages stemming from drought conditions which contributed positive performance for the short portfolio.

Portfolio Highlights

Positives:
Xero Ltd (Long) – The Company surpassed 2m subscribers at its 1H20 result with strong growth stemming from digital government tax initiatives in Australia and UK. The size of the Company's ecosystem has started to gain momentum with platform revenues growing at over 100% for the past 2 reporting seasons.

Fortescue Metals Group Ltd (Long) – The Company had a solid start to FY20 with recent strong demand from China. Management renewed a $500m share buyback program and confirmed the Eliwana and Iron Bridge projects remain on schedule and on budget.

OZ Minerals Ltd (Long) – The Company's new Carrapateena mine produced its first copper concentrate during the quarter. Management also revealed the production ramp up to full capacity has been shortened from 18 months to 12 due to a larger sub-level cave footprint and mine optimisation.

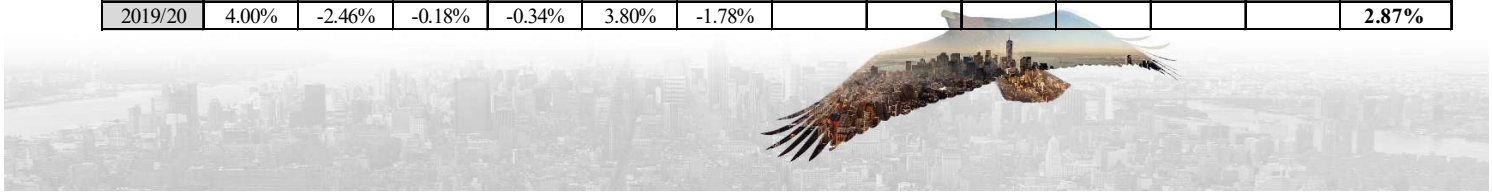
Negatives:
Virgin Money UK plc (Short) – The share price rebounded after Boris Johnson won re-election as the UK PM to alleviate some uncertainty about an orderly Brexit from the EU. The Bank was previously under pressure after being found guilty of mis-selling financial products and misleading consumers.

Caltex Australia Ltd (Short) – The share price rose after the Company received a non-binding indicative conditional proposal from an international petrol and convenience operator. The Company also announced plans for a property IPO for 250 core freehold sites to release capital.

National Australia Bank Ltd (Long) – The share price fell after ASIC launched a lawsuit against the bank claiming they charged fees for no service 10,000 times, potentially resulting in a $10bn fine.

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%	-7.62%	-0.53%	2.23%	5.98%	3.70%	1.76%	3.65%	2.15%	6.57%	**16.27%**
2019/20	4.00%	-2.46%	-0.18%	-0.34%	3.80%	-1.78%							**2.87%**



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Market Overview

The Australian market was flat over the December quarter as the big banks suffered more regulatory issues offset by rises in the big miners. Elders reported a flat profit for FY19 amid tough drought conditions. National Australia Bank received a lawsuit from ASIC with a potential $10bn fine for charging fees for no service. Altium introduced 2025 targets with an additional "Rule of 50" which includes a minimum EBITDA margin of 37%. OZ Minerals announced its Carrapateena mine produced its first copper concentrate during the December quarter.

Portfolio Changes

Increased Exposure:

Challenger Ltd (+2.25%; Short): An annuities and funds management company. Sales in Japan have recovered after the Company reinsured USD denominated annuities. FY20 NPAT guidance was reconfirmed with FUM also increasing 3% to $84bn in the 1st quarter of FY20.

Lendlease Group Ltd (+2.25%; Long): A multinational construction and property funds management company. The Company has sold its Engineering business with no change to its restructuring cost estimate. The Company has experienced a strong start to FY20 and reconfirmed plans to focus on its growing $100bn Development pipeline.

Pushpay Holdings Ltd (+1.75%; Long): A faith sector donor management system company. The Company acquired a church management system provider which added over 2,000 net new customers and will be earnings accretive from FY22 onwards.

Decreased Exposure:

NextDC Ltd (-2.50%; Exit Long): An Australian data centre owner and operator. The share price has reached our valuation target. The Company has experienced difficulties in attracting new customers to its data centres outside of Sydney.

Cleanaway Waste Management Ltd (-3.75%; New Short): An Australian waste management company. The Company recently warned of flat 1H20 earnings due to soft economic growth, falls in commodity prices and a reduction in Queensland volumes stemming from the introduction of a new landfill levy.

Bank of Queensland Ltd (-2.25%; New Short): An Australian regional bank. The Company experienced higher costs and falling profits in a difficult external environment. Increasing competition, declining interest rates and a rise in regulatory costs are presenting strong headwinds to future growth.

Quarter-End Position & Portfolio Exposures

As at 31 December 2019, the fund had a net exposure of 94.83% and gross exposure of 194.72% to equities. Cash was 5.17%.

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

Stock Highlight

An Asymmetric Risk/Reward?

Japara Healthcare Limited (JHC) – Long Position

Growth Delta Argument: Japara Healthcare is currently suffering from low occupancy rates and uncertainty in the face of the Royal Commission into Aged Care Quality and Safety despite the long-term industry tailwind of a rapidly ageing population. The Company has a development pipeline of over 1,100 new operational places within the next 3 years to bring the total number in excess of 5,400 in order to cope with the surging demand. The confidence in the quality of corporate governance and the operational team is supported by being the only listed aged care provider to maintain 100% re-accreditation upon regulatory reviews and unannounced audits. The Company's balance sheet has historically been the most conservative of the three listed sector peers. With the stock trading on about 5% yield and only 0.5x of the property-backed book value, this may be interpreted as a deep value stock entry which is in contrast to our traditional growth bias. However, Australian Eagle believes the situation represents minimal downside but with opportunity for significant earnings growth once the recent issues have been rectified.

Trigger: The recent maintenance of 100% payout ratio provides confidence in continued receipt of Refundable Accommodation Deposit funding and earnings outlook. The Company continues to win new bed licenses each year as well as continually build new facilities and refurbish existing ones. The CEO has recently taken a reduced cash salary in lieu of Company shares.

Outlook: Post the immediate term weakness, increased regulation costs resulting from the Royal Commission will cause smaller operators to exit and the better run larger operators like Japara will naturally increase occupancy and capacity. The EBITDA and share price potential on forecast beds is more than double the current level should they be able to attain historical occupancy and their own recent forecast margins. Our call that there is minimal downside is supported by a property-backed book value that is 2x the current stock price, despite being carried at historical cost.

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About the Australian Eagle Trust Long-Short Fund

Australian Eagle Asset Management Ltd is an Australian boutique wholesale fund manager specialising in Australian equities. Australian Eagle'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 outperform the Australian equity market over a period of 5 years by allowing clients to access Australian Eagle's demonstrated historical strength in constructing Australian share portfolios applied to a long-short product.

How to Invest

The Australian Eagle Trust Long-Short Fund is only available to investors via the Australian Eagle Trust Product Disclosure Statement (PDS) that is available on www.austeagle.com/how-to-invest/. The Product Disclosure Statement offers investors the opportunity to invest a minimum of $25,000 in the Australian Eagle Trust (the Fund). The Responsible Entity has the discretion to waive or vary this minimum requirement.

The offer of units in the Fund are available to investors both residents in Australia, New Zealand and elsewhere receiving this document (including electronically) in Australia, New Zealand or elsewhere. Investors who are not residents in Australia can invest in the Fund where they are permitted by law to do so. The Trust Company (RE Services) Ltd ABN 45 003 278 831 AFSL 235150, part of Perpetual Ltd, is the responsible entity and issuer of units in the Australian Eagle Trust ARSN 632 568 846. The Investment Manager of the Fund is Australian Eagle Asset Management Pty Ltd ABN 89 629 484 840, a corporate authorised representative of Alleron Investment Management Pty Ltd AFSL 278856.