



# Australian Eagle Asset Management

## Long-Short Quarterly Report – December 2020

### FOR WHOLESALE INVESTORS ONLY

#### Portfolio Performance

As at 31 December 2020	3mth	6mth	1yr	2yr p.a.	3yr p.a.	4yr p.a.	Net Return S/I p.a.
Aust. Eagle Long-Short*	3.70%	5.53%	7.29%	18.00%	12.89%	14.93%	16.62%
S&P/ASX 100 Acc**	13.78%	12.89%	0.80%	11.82%	6.89%	7.91%	9.50%
Out/(under) performance	-10.08%	-7.36%	6.49%	6.18%	6.01%	7.02%	7.12%

Performance is net of fees and expenses, \*Inception date 1 July 2016, \*\*Performance benchmark

Past performance is not an indicator of future performance

#### Portfolio Commentary

The Portfolio returned +3.70% after fees for the December 2020 quarter. For the calendar year 2020, the Portfolio returned +7.29% vs +0.80% for the ASX 100 Accumulation Index. Throughout 4 and a half years of operation, the investment team has maintained focus on investing in high quality companies, thus generating outperformance of +7.12% p.a. since July 2016.

The December quarter was a challenging period for the Portfolio with the announcement of 3 successful vaccines to be rolled out to Western countries. This resulted in a sharp reversal of lower quality stocks where the portfolio had short positions, with many rising almost back to pre-COVID-19 market capitalisation levels. With ongoing volatility, it became prudent to reduce the gearing ratio of the Portfolio by 25% to 137.5/35.7% for the short term. The investment team will continue to closely monitor the situation in order to bring the leverage ratio back up to 150/50%. Upside in a number of short positions seem to be limited from here with complete earnings recovery remaining years away.

The Long side of the portfolio contributed to performance as resources stocks rallied on an increasingly positive economic recovery outlook. Fortescue Metals benefited from a surging iron ore price stemming from strong Chinese steel production. OZ Minerals reported record production numbers while rising copper prices became a favourable tail wind for the share price. Japara Healthcare rose with the rest of the aged care sector, boosted by a takeover bid received by a competitor.

The Short side of the portfolio detracted from performance due to the sharp reversal of lower quality stocks. Challenger rallied during the quarter despite the quarterly update reporting total Life sales falling -11% and reconfirming 2 consecutive financial years of declining profits. Virgin Money UK revealed a significantly smaller FY20 profit affected by large impairment provisions and weaker net interest margins. Unibail-Rodamco Westfield rose with other retail property trusts after the vaccine announcement. Management added more debt to their leveraged balance sheet, pricing a EUR2bn bond issue during the quarter for general corporate use.

#### Portfolio Highlights

##### Positives:

*OZ Minerals Ltd* (Long) – The Company has completed its ramp up of its low cost Carrapateena mine production 6 months ahead of schedule. The Sep 20 quarterly report also revealed further reductions to unit production costs due to record production numbers at its flagship Prominent Hill mine.

*Xero Ltd* (Long) – The Company's HY21 result revealed significant profit and free cash flow growth resulting from cost cutting despite subscriber growth slowing due to lower economic activity during COVID-19 restrictions. Management also issued US\$700m worth of convertible notes for acquisition purposes.

*Japara Healthcare Ltd* (Long) – The share price rose after a competitor received a takeover bid in the lead up to the Final Report from the Royal Commission into Aged Care in Feb 2021. The Company announced at their AGM that their facilities in Victoria were recently cleared of any active COVID-19 cases.

##### Negatives:

*Challenger Ltd* (Short) – The share price rose after the Sep 20 quarterly report revealed a +4% increase in assets under management to \$89bn and reconfirmed lower FY21 profit guidance range. The Company's annuity business remains under pressure from low interest rates and uncertainty with its financial advisory distribution channel.

*ASX Ltd* (Long) – The share price fell after the ASX suffered software issues in November, forcing it to close for almost an entire trading day. Although the issue has been fully resolved, the Company's commitment to modernising its operations has resulted in speculation of increased regulatory oversight from ASIC.

*Virgin Money UK* (Short) – The share price rose after the announcement of the imminent rollout of the COVID-19 vaccine in Europe. The Company's FY20 result showed a significant drop in mortgage lending activity as well as falling net interest margin from lower interest rates. Government-guaranteed lending artificially boosted Business Lending growth by GBP1.2bn.





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## Market Overview

The Australian market rallied during the December 2020 quarter with the announcement of the rollout of COVID-19 vaccines. Many company AGMs revealed trading updates with Cochlear reporting tough trading conditions in Europe due to lockdowns restricting elective surgeries. HUB24 announced 3 strategic acquisitions to make it the largest new generation wealth management platform in Australia. Chorus reported continued strong uptake in fibre broadband connections.

## Portfolio Changes

### Increased Exposure:

*Corporate Travel Management Ltd* (+2.00%; New Long): A multinational corporate travel service manager. The Company's clean balance sheet and prudent cost management have enabled management to acquire a highly complementary acquisition in the US, the largest corporate travel market in the world.

*Downer EDI Ltd* (+1.75%; Short): A diversified engineering and infrastructure maintenance provider. The planned divestment of non-core assets in Laundries and Mining Services is starting to gain traction. The new Urban Services strategy's focus on infrastructure has resulted in some recent successful contract bids.

*Vicinity Centres* (+1.50%; Short): An Australian retail property owner and manager. The Company's properties outside of Victoria and CBD areas have experienced growing foot traffic for the past 6 months. However, low levels of rent collection remain a persistent problem.

### Decreased Exposure:

*ASX Ltd* (-2.50%; Long): An Australian stock exchange owner and operator. The Company has suffered reputational damage after its one day shutdown from IT issues. ASIC have expressed concerns about market integrity as well as suggesting an increased role for Chi-X as an alternative exchange.

*AGL Energy Ltd* (-1.75%; Short): An Australian energy retailer and producer. The Company has downgraded FY21 earnings due to lower wholesale prices, expiration of cheap long term gas contracts and increased retail competition for customers. Operational units have also experienced recent outages at Loy Yang and Liddell, resulting in shutdowns for many months.

*A2 Milk Company Ltd* (-1.50%; Short): A multinational niche dairy products company. COVID-19 travel restrictions and increased Sino-Australian political tensions have stifled growth plans. The Company has downgraded FY21 earnings in light of a further deterioration of trading conditions due to a lack of Chinese tourists.

## Quarter-End Position & Portfolio Exposures

As at 31 December 2020, the fund had a net exposure of 96.07% and gross exposure of 170.07% to equities. Cash was 3.93%.

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

## Stock Highlight

### Upside Opportunity After Improvement in Quality

#### Incitec Pivot Limited (IPL) – Long Position

*Growth Delta Argument:* AEAM has long term knowledge of Incitec Pivot having previously established a holding and benefiting from significantly increased fertiliser demand in 2007/08. At that time of entry prior to the fertiliser boom, the company had just purchased the Di-Ammonium Phosphate (DAP) producing Phosphate Hill from BHP at an attractive price and were embarking upon a strong efficiency program. Management have since acquired Dyno Nobel which enhanced their setup with technologically ground-breaking explosives operations to complement their existing fertiliser business. An efficiency plan has been implemented to improve manufacturing reliability from 80% to 95%, delivering up to \$120m in annual efficiency benefits and further increase margins should the rise in fertiliser and explosives demand continue.

*Trigger:* Historically, AEAM has preferred exposure to commodity producers that hold world class assets as IPL has, and enter at a time when both their underlying commodity markets are relatively weak along with an improvement in their operating quality. As with other recent purchases, the trigger to enter Incitec Pivot was the culmination of a number of events. The HY20 report showed improvement in production consistency and earnings outlook despite some of the weakest fertiliser prices in the nearly 20 years of our research coverage of the company. The company also raised about \$700m in equity to pay down debt.

*Outlook:* We do not see significant downside risk to the stock given the improved balance sheet, better production quality and relatively fair valuation despite the weak commodity pricing environment. Company efficiency gains could also support +20% in earnings growth. The latest company update has also indicated that commodity prices are recovering, in addition to a 14% growth in domestic fertiliser sales volume stemming from recent drought-breaking rain. Should this price and demand momentum continue, Incitec Pivot is well placed for significant earnings upside, given the improved state of their operations.





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## 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%	<b>24.48%</b>
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%	<b>25.13%</b>
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%	<b>16.27%</b>
2019/20	4.00%	-2.46%	-0.18%	-0.34%	3.80%	-1.78%	5.45%	-6.50%	-16.24%	8.32%	9.97%	3.34%	<b>4.59%</b>
2020/21	3.60%	1.83%	-3.53%	4.35%	-0.62%	0.00%							<b>5.53%</b>

Past performance is not an indicator of future performance. Net monthly returns are calculated using exit prices after taking into account all of the Australian Eagle Trust's ongoing fees as disclosed in the PDS and assuming reinvestment of distributions. No allowance has been made for entry fees, the buy sell spread or taxation.

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

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