



# Australian Eagle Asset Management

## Long-Short Quarterly Report – March 2021

### FOR WHOLESALE INVESTORS ONLY

#### Portfolio Performance

As at 31 March 2021	3mth	6mth	1yr	2yr p.a.	3yr p.a.	4yr p.a.	Net Return S/I p.a.
<b>Aust. Eagle Long-Short*</b>	<b>3.46%</b>	<b>7.29%</b>	<b>34.41%</b>	<b>13.50%</b>	<b>13.62%</b>	<b>14.55%</b>	<b>16.53%</b>
S&P/ASX 100 Acc**	4.46%	18.86%	36.77%	8.62%	9.90%	7.76%	9.99%
Out/(under) performance	-1.00%	-11.57%	-2.35%	4.88%	3.72%	6.80%	6.54%

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 +3.46% after fees for the March 2021 quarter. Now approaching 5 years of operation through volatile market conditions, the Fund has maintained its longer term outperformance with methodical implementation of the investment process by the team. The Fund has generated positive performance over the benchmark of +6.54% p.a. since July 2016.

The March quarter continued to be a challenging period for the Portfolio as long term bond yields rose on fears of rising inflation, resulting in stocks with large longer dated earnings underperforming the market. Cyclical and travel/leisure related stocks benefited from news of the global vaccination rollout, continued fiscal stimulus and easy monetary policy. With the sharp reversal experienced in the Dec 2020 quarter largely over, the team decided to bring the leverage ratio back up to 150/50% at the end of January before the start of reporting season.

The Long side of the portfolio detracted from performance as some stocks suffered due to rising bond yields in addition to company specific headwinds. Altium experienced a slowdown in revenue due to COVID-19 despite faster than anticipated adoption of its new cloud-based Altium 365 platform. AMP faced increased distractions with prolonged negotiations regarding the sale of its Private Markets division to Ares Management. Fortescue endured a volatile quarter due to the iron ore correction as Chinese authorities cracked down on pollution from inefficient steel mills.

The Short side of the portfolio contributed to performance as some COVID-19 affected stocks continued to endure tough operating conditions, coupled with bleak forecasts. A2 Milk continued to struggle with an extended disruption to the daigou/reseller channel due to COVID-19 travel restrictions in addition to growing Sino-Western political tensions and Chinese nationalism. AGL Energy reported decreasing profits due to a sharp decline in wholesale electricity prices and lower gross margins for wholesale gas. Appen revealed slowing revenue growth due to reduced online advertising and contract cyclicality for both its Relevance and Speech & Image divisions.

#### Portfolio Highlights

##### Positives:

*OZ Minerals Ltd* (Long) – The share price followed as the copper price rose 14% during the quarter. The Company achieved FY20 production and cost guidance along with approval of the Carrapateena block cave project which will commence construction in 4Q21. The Prominent Hill expansion and West Musgrave studies also progressed to advanced stages.

*A2 Milk Company Ltd* (Short) – The Company's HY21 result revealed the continuing challenges faced with its distribution channels due to COVID-19, resulting in slowing revenue growth and smaller EBITDA margins. Management has downgraded FY21 guidance due to the slower-than-anticipated recovery in Chinese volumes.

*AGL Energy Ltd* (Short) – The share price fell as management booked over \$2.6bn in impairments and provisions relating to onerous contracts for legacy wind farm offtake agreements, environmental restoration provisions and impairments for its Generation Fleet and Natural Gas assets. Management have further downgraded profit guidance for FY21 as the company faces a tough operating environment.

##### Negatives:

*Altium Ltd* (Long) – The share price fell as revenue declined from the economic slowdown caused by COVID-19 and license compliance issues in China. However, the core Boards and Systems division has shown continued recovery momentum into 2H21 and the Company's long term goal of 100k subscribers by 2025 remains intact.

*AMP Ltd* (Long) – The share price fell after Ares Management chose not to proceed with their 100% takeover bid but announced their intention to pursue a 60/40 JV for AMP Capital Private Markets, later changing this to acquiring 100% of Private Markets division. The 3 year transformation plan remains on track to deliver \$300m annualised savings by FY22.

*Fortescue Metals Group Ltd* (Long) – The share price followed the iron ore price lower as Management announced the departure of some senior executives who mismanaged the upcoming Iron Bridge project. The Company has increased FY21 shipment guidance to 178-182mt after a strong 1H21 operational performance with continued focus on productivity and innovation.





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## Market Overview

The Australian market rose during the March 2021 quarter as financial and monetary stimulus continued to support the recovering economies around the world. February reporting season produced mixed results with domestic retailers benefiting from 2020 travel restrictions while strong commodity prices supported the iron ore and copper miners. Nearmap announced a return to growth in the US under its new 3 pillars strategy. Macquarie Group upgraded guidance due to an uplift to its Commodities & Global Markets division from the sudden US freeze event.

## Portfolio Changes

### Increased Exposure:

*Telstra Corporation Ltd* (+4.50%; New Long): An Australian telecommunications and infrastructure company. Management has detailed plans for a corporate restructure which will begin with monetising the mobile tower assets from July 2021. The T22 strategy to increase underlying EBITDA to between \$7.5-8.5bn is less than 18 months away from completion.

*Incitec Pivot Ltd* (+3.00%; Long): A multinational explosives and fertiliser business. Management has shown strong progress in delivering its manufacturing and operations efficiency plans while the fertiliser price has started to increase after a period of record lows experienced during the recent drought.

*BHP Group Ltd* (+2.75%; Long): A large low cost multinational diversified mining group. The Company's South Flank iron ore mine is on track for first production by mid 2021 while the Brazilian Samarco mine has just restarted production in Dec 2020.

### Decreased Exposure:

*Appen Ltd* (-3.50%; New Short): An Artificial Intelligence training data company. Management downgraded profit guidance after experiencing difficult operating conditions in FY20. The Company continues to face a challenging environment with lumpy and unpredictable contract flows from large customers as well as a strong AUD headwind.

*AGL Energy Ltd* (-3.00%; 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. Management also booked \$2.6bn provisions for onerous wind farm contracts and asset impairments.

*Newcrest Mining Ltd* (-2.50%; New Short): A multinational gold mining company. Management is facing an uphill struggle to turnaround underperforming mines at Telfer and Lihir in addition to a falling gold price.

## Quarter-End Position & Portfolio Exposures

As at 31 March 2021, the fund had a net exposure of 95.47% and gross exposure of 190.10% to equities. Cash was 4.53%.

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

## Stock Highlight

### **The Break-Up!**

#### Telstra Corporation Limited (TLS) – Long Position

*Growth Delta Argument:* When determining new investments for the portfolio, our process requires us to not only look for growth but more importantly, search for a changing growth profile. Telstra has had negative earnings pressure ever since the NBN started migrating customers from the Telstra Network. With the transition nearing completion, the Company needed to reset its cost base and setup a new corporate structure to remain a viable business afterwards. Telstra still possesses privileged infrastructure assets, whose value and capital allocation requirements demand focussed vehicles and shareholders in order to extract their full value.

*Trigger:* In order to invest into a company, AEAM require a trigger that confirms that change is taking place according to our expectations. This is sometimes the culmination of multiple pieces of evidence or as in the case for Telstra, a single event. At a recent investor day, Telstra management highlighted the previously announced restructure for the group containing 3 infrastructure companies and one customer facing company. Further, they set a timeframe for the information memorandum to be sent out to monetise the first of these infrastructure businesses. This is happening in conjunction with management's T22 strategy to turnaround underlying core earnings through an unrelenting focus on increased efficiency and productivity.

*Outlook:* In its current state, AEAM sees limited downside as there are signs of underlying earnings growth which may flow into future shareholder returns. Nevertheless, by breaking up and monetising Telstra assets, the market will be able to adequately value the different parts of the company as independent businesses. Should the parts be listed separately, the passive infrastructure income producing assets could achieve a total valuation of over \$25bn. Furthermore, the improved earnings growth outlook is expected to be focussed on the client-facing service company and not diluted across the group. With such focused growth, this could improve valuation multiples to 10X EBITDA, potentially providing an Enterprise Value uplift to over \$70bn for different parts combined versus about \$50bn currently.





# Australian Eagle Asset Management

## 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%	0.13%	1.86%	1.45%				<b>9.18%</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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