Australian Eagle Asset Management

Long-Short Fund Quarterly Report – Sep 2023

FOR WHOLESALE INVESTORS ONLY

Portfolio Performance

As at 30 Sep 2023	3mth	6mth	1yr	2yr p.a.	3yr p.a.	5yr p.a.	7yr p.a.	Net Return S/I p.a.
Aust. Eagle Long-Short*	**0.23%**	**-1.25%**	**7.54%**	**5.28%**	**12.89%**	**12.66%**	**14.06%**	**15.10%**
S&P/ASX 100 Acc**	-0.71%	0.45%	13.66%	3.43%	11.90%	7.27%	8.47%	8.88%
Out/(under) performance	0.94%	-1.70%	-6.12%	1.85%	0.99%	5.38%	5.59%	6.22%

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 +0.23% after fees for the September 2023 quarter outperforming the benchmark by +0.94%. After a negative start to the quarter, the Fund rebounded strongly in August and September while the broader market fell. Now moving into its 8th year of operation for the Australian Eagle Trust, the consistent process implementation by the Australian Eagle investment team has delivered positive long-term outperformance of the S&P/ASX 100 Accumulation Index by +6.22% p.a. since July 2016.

World markets continued to experience significant volatility as bond yields surged on an increasingly unclear outlook for central bank interest rate hikes. The US Fed only raised rates by 25bps during the quarter to a 5.25% to 5.50% range but the chairman stated that the fight against high inflation is not over. The yield curve steepened slightly as short-term yields edged up while longer term bond yields rallied. Sino-Australian political relations showed signs of improvement as politicians commenced preliminary talks to end import tariffs on Australian-made wine. The iron ore price rose US$8 to US$118/t as the Chinese government announced some measures to support its declining property market. The oil price surged US$19 to US$89/bbl as OPEC+ announced further extensions to current production cuts.

The Long portfolio contributed to relative performance after overweight positions reported strong results during reporting season. Altium reported pleasing growth despite China's well publicised slowing economy. Cochlear announced strong double-digit growth as the company works through the backlog of COVID-19 delayed surgeries. Costa Group also contributed as the board of directors recommended shareholders accept a takeover offer from a large private equity shareholder.

The Short portfolio detracted from performance in July but recovered part of the underperformance in August and September as some positions announced poor fundamentals during reporting season. Whitehaven Coal rose with the coal price despite reporting continued operational issues. Domino's Pizza also rose despite a tepid outlook statement highlighted by negative Asian sales growth. Incitec Pivot also rallied as the company announced progress in the sale of its troubled fertiliser business.

Portfolio Highlights

<u>Positives</u>:

Altium Ltd (Long) – The share price rose after the company's annual report revealed strong growth from all divisions despite multiple operating headwinds. Higher paying subscriptions continued to drive margin expansion in the core business as management reiterated its long-term aspirations for FY26.

Cochlear Ltd (Long) – The share price rose after the company's recovery from COVID-19 continued to gain momentum, helped by the rollout of the new Nucleus 8 Sound Processor. The company also commenced production of sound processors in China, with approvals for implant manufacturing expected within the next 18 months.

AMP Ltd (Long) – The share price outperformed after the company announced a significantly smaller than expected provision for its Buyer-Of-Last-Resort court case. The company also confirmed that its capital management plans remain on track with a further $140m to be returned to shareholders through dividends and buybacks before the end of the year.

<u>Negatives</u>:

ResMed Inc (Long) – The share price fell after the market became concerned with the decrease in market size for sleep apnoea due to the recent surge in popularity of new weight loss drugs. Management also reported problems with maintaining gross margins due to cost inflation and an unfavourable product mix.

Whitehaven Coal Ltd (Short) – The share price followed the coal price higher as energy prices rose throughout the quarter. Production volumes continue to be significantly affected due to labour shortages as well as localised flooding at a number of operating sites earlier in the year. Production costs have also been forecast to rise for FY24.

Transurban Group (Long) – The share price fell in the quarter as rising bond yields resulted in a sell off of bond proxies. The company reported a continued recovery in traffic volumes from a COVID-19 downturn while also declaring growing distributions due to rising revenue and profits as inflation-linked tolls started to take effect.

Market Overview

The Australian market followed international markets lower as the RBA paused its hiking cycle in the quarter. Macquarie downgraded its short-term outlook due to lower green energy investment income and a tough deal making environment. Pro Medicus won a $140m 10 year contract, their biggest contract win to date. CSL reported increased operational efficiency with plans to significantly improve immunoglobulin production yield in the medium term. Telix Pharmaceuticals announced the planned launch of brain and renal cancer diagnostic products in 2024.

Portfolio Changes

Increased Exposure:

Lendlease Ltd (+3.00%; Short): A diversified property trust and developer. Management's turnaround plan is making progress with $150m cost cuts and $1.3bn divestments so far to reset their asset base. The company has also entered the build-to-rent market, a relatively new and budding sub-sector of the property market.

Downer EDI (+2.50%; Short): A diversified infrastructure maintenance and engineering company. Management has begun its turnaround, starting with a complete management refresh, asset divestments, impairments and balance sheet repair. The company has recently won a few large long-term government contracts.

Deterra Royalties Ltd (+2.00%; Long): A mining royalties company. The company's main asset, Mining Area C, is set to increase mining capacity in FY24 while management continue to assess new acquisition targets to expand and improve the quality of its royalties portfolio.

Decreased Exposure:

Alumina Ltd (-2.25%; Entry Short): An 40% owner of an alumina joint venture with Alcoa. The JV has encountered significant delays with mining permits while existing operations were affected by lower grade bauxite, higher production costs and lower realised prices.

Newcrest Mining Ltd (-2.25%; Long): A multinational gold miner. The company is under an imminent takeover offer from Newmont, a large global gold miner. The combined entity is projected to dilute the under-appreciated growing copper production of Newcrest Mining.

The A2 Milk Company Ltd (-2.00%; Short): A vertically integrated dairy products company. The total addressable market size of infant milk formula in China is declining at over 14% p.a. Relations with one of its largest suppliers, Synlait, have reached breaking point with the A2 Milk company cancelling their exclusive manufacturing and supply rights.

Quarter-End Position & Portfolio Exposures

As at 30 September 2023, the fund had a net exposure of 96.7% and gross exposure of 194.2% to equities. Cash was 3.3%.

Major portfolio exposures were to medical devices & services and infrastructure with less portfolio weight in major banks and real estate.

Mining Exposure With Less Volatility

This stock highlight is not an investment recommendation and is intended to be read in the context of the Australian Eagle portfolio.

Deterra Royalties Ltd (DRR) – Long Position

Originally wholly owned by Iluka Resources (ASX:ILU), Deterra was spun out in late 2020. The Australian Eagle investment team had long appreciated the assets of Deterra while it was owned by Iluka due to the cashflow reliability and optionality it provided. Among its many mining royalties, the crown jewel is Mining Area C (MAC), a world class iron ore mine hub majority owned and operated by BHP.

In the last financial year, BHP increased MAC production capacity from 105mt to 118mt and have indicated their intention to ramp up to full capacity of 145mt by the end of FY24. This should make MAC the largest single iron ore hub in the world.

With royalty payments calculated on revenue and not profits, this arrangement favours Deterra, especially in the current environment where the iron ore price remains elevated. Mining companies have recently struggled to contain higher production costs stemming from labour shortages, fuel increases and general cost inflation. MAC provides Deterra with the benefits of higher production and commodity prices with much less downside than owning an iron ore mine.

Externally, iron ore represents almost a quarter of Australia's exports, so a profitable iron ore industry would also mean both Australia and Deterra are doing well. A falling AUD relative to the USD will also provide a buffer for miners during periods of commodity price weakness.

With no drawn debt and a minimal operating cost base, the 100% payout ratio yields over 6 per cent at current share price levels. The dividend yield could further increase if BHP delivers on its expansion plans at MAC.

Management has signalled their intention to acquire additional royalty assets by expanding their debt facilities and hiring additional team members to assess acquisition targets, mainly in the battery and base metals space.

These recent developments signify Deterra's shift into a new phase of their journey. The strong downside protection inherent within the company's operations provide comfort if expansion plans do not work out but the team remain cognisant of the company's progress as well as the movements and sentiment surrounding iron ore in the global economy.

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%	5.45%	-6.50%	-16.24%	8.32%	9.97%	3.34%	**4.59%**
2020/21	3.60%	1.83%	-3.53%	4.35%	-0.62%	0.00%	0.13%	1.86%	1.45%	7.26%	3.63%	4.02%	**26.24%**
2021/22	3.37%	3.02%	-1.76%	2.64%	0.63%	3.25%	-9.77%	-0.47%	9.88%	2.54%	-3.88%	-4.39%	**3.73%**
2022/23	1.92%	5.56%	-3.40%	3.69%	5.96%	-3.57%	1.99%	-0.86%	1.66%	2.19%	-4.77%	1.25%	**11.51%**
2023/24	-0.32%	1.79%	-1.21%										**0.23%**

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.

This fund is appropriate for investors with a "Very High" risk and return profiles. A suitable investor for this fund is prepared to accept high risk in the pursuit of capital growth with a medium or long investment timeframe. Investors should refer to the TMD for further information.

How to Invest

The Australian Eagle Trust Long-Short Fund is only available to investors via the Australian Eagle Trust Product Disclosure Statement (PDS). The PDS and target market determination can be obtained by calling 02 8252 7559 or visiting our website http://austeagle.com/how-to-invest/ for the PDS or https://documents.feprecisionplus.com/Tmd/PCT/TMD/P9IYALR2783AU.pdf for the target market determination.

The PDS offers investors the opportunity to invest a minimum of $20,000 in the Australian Eagle Trust (the Fund). The Trustee has the discretion to waive or vary this minimum requirement. The offer of units in the Fund are available to investors who are resident in either Australia or New Zealand. 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 Limited, 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 and a corporate authorised representative of Montgomery Investment Management Pty Ltd AFSL 354564.