Australian Eagle Asset Management

Australian Eagle Trust (Long-Short Fund) Quarterly Report – September 2024

The underperformance of the Fund over the last few years has been painful for investors as well as the investment team. Both Long and Short portfolios have detracted in recent months as the performance of the detracting stocks overwhelmed the winning stocks. The S&P/ASX 100 Accumulation Index is dominated by the big banks and big miners and any large moves by any one of these stocks tends to have an outsized effect on index performance.

As readers may be aware, the big banks have rallied strongly for 2024 calendar year to date and the Fund remains underweight the big banks. The implementation of the investment process has not detected a valid change argument to justify a strong banks position, specifically not owning Westpac and ANZ.

Long portfolio stock selection of winners in 2024 has been pleasing, with sizeable positions in Altium, Telix Pharmaceuticals and ResMed all contributing strongly. However, detracting stocks cancelled out the performance of the winners with long resources positions disappointing due to China's weak economy. The short portfolio has also been impacted during the year by several takeover situations of highly leveraged lower quality cyclical stocks, namely Alumina and Orora. Overall fair performance of the remaining portfolio constituents failed to boost returns in a meaningful way.

We continue to diligently apply our investment process of uncovering companies with a medium-term change thesis and are comforted, knowing that the Fund has previously recovered from underperforming periods and subsequently delivered returns in line with its historical track record.

Portfolio Performance

As at 30 Sep 2024	3mth	6mth	1yr	3yr p.a.	5yr p.a.	7yr p.a.	Net Return S/I p.a.
Aust. Eagle Trust*	**0.97%**	**-2.37%**	**5.35%**	**5.30%**	**9.75%**	**12.37%**	**13.87%**
S&P/ASX 100 Acc**	7.94%	7.09%	22.02%	9.28%	8.80%	10.12%	10.39%
Out/(under) performance	-6.97%	-9.45%	-16.67%	-3.99%	0.95%	2.25%	3.48%

Performance is net of fees and expenses, *Inception date 1 July 2016, **Performance benchmark
Past performance is not an indicator of future performance

Portfolio & Market Commentary

The Fund returned +0.97% after fees for the September 2024 quarter underperforming the benchmark by -6.97%. The Fund endured another volatile quarter with big banks continuing their 2024 rally to record low dividend yields until a sharp reversal triggered by a Chinese stimulus announcement occurred in the second last week of the quarter.

World markets were mostly higher, boosted by a 50bps interest rate cut by the US Federal Reserve and Chinese stimulus announcement. In the lead up to the interest rate cut, Fed Chair Jerome Powell had consistently stated that the time for cutting rates had arrived. Backed by strong employment and inflation data, Powell also confirmed that this would not be the start of an aggressive cutting cycle, resulting in a continued downtrend of US treasury yields. Chinese economic data continued to paint a dour picture, resulting in a 1 trillion yuan government stimulus. The iron ore price had fallen below US$90/t in the lead up to the stimulus announcement and promptly rallied over 20% to US$109/t by the end of September. Surprisingly, most other commodity prices including copper and lithium only rose 2% in the same period.

The Long portfolio detracted from relative performance due to some company specific announcements which were unfavourably received by the market as well as sector rotation. Cochlear gave a softer than expected FY25 outlook statement, affected by one-off costs associated with its ramp up of China operations. Underweight big banks exposure also resulted in a drag on Long portfolio performance as the sector rise surpassed all expectations, continuing deep into the quarter. Not owning Westpac and ANZ while being underweight National Australia Bank resulted in over 1% underperformance.

The Short portfolio also detracted from performance due to merger and acquisition activity as well as a low-quality company rally. Orora rallied strongly after rejecting an unsolicited takeover bid and later sold an underperforming division at a generous earnings multiple. Lendlease's long-term turnaround plan finally started gaining traction despite hitting multiple roadblocks such as regulatory delays, rising debt and costs. Qantas also rallied due to a new $400m buyback despite political and social pressure on executive remuneration and high airfares.

Portfolio Highlights

Positives

TechnologyOne Ltd (Long) – The share price rose after management fast tracked its medium-term target of $500m Annualised Recurring Revenue twice from FY26 to FY25 and now to 1st Half of FY25. The UK division is also gaining significant traction with the company securing large education institutions with multi-year contracts.

ResMed Inc. (Long) – The share price recovered after earlier suffering from elevated shipping costs and threats to its market size from new weight loss drugs. The most recent quarterly report revealed margin expansion through volume growth and cost control while its SaaS business accelerated to low double-digit rates.

Rio Tinto Ltd (Long) – The share price rose at the end of the quarter with the iron ore price after the Chinese government announced strong stimulus plans. Maintaining its place as one of the lowest cost iron ore producers in the world, the company remains in good shape with a solid balance sheet while retaining growth options in copper and lithium.

Negatives

Orora Ltd (Short) – The share price rose after receiving an unsolicited takeover bid from a global private equity firm. Despite reporting a mediocre result for FY25, management announced the sale of its underperforming North American packaging business for a premium to its own valuation multiple, representing almost half of its market capitalisation.

Lendlease Ltd (Short) – The share price rose despite reporting a $1.5bn loss during the quarter. The company's complicated strategy refresh to divest international divisions while continuing to cut costs and sell non-core assets represented significant execution risk while juggling higher debt levels and regulatory delays.

Cochlear Ltd (Long) – The share price fell after reporting a softer outlook as some one-off costs will temporarily pause the growth trajectory of earnings. The ramp up of production in their new Chinese factory in Chengdu will incur additional costs in the near term but will benefit the company in the long term as they provide emerging countries with more cost-effective product solutions.

Portfolio Changes

Increased Exposure

South32 Ltd (+3.00%; Short): A diversified multinational miner. The company has continued to struggle with the inflationary environment resulting in lower production volumes, higher operating costs and higher interest expense. Lower commodity prices have also put pressure on margins.

Endeavour Ltd (+2.50%; Exit Short): An Australian liquor retailer and licensed premises owner and operator. After a profitable holding period in the short portfolio, this was exited after reaching its time stop.

Qantas Ltd (+2.25%; Short): A domestic and international Australian airline operator. The company reported margin compression, driven by airfare deflation and higher fuel and wages. The company also faces a growing capex bill with 20 new planes to arrive in FY25 as they look to replace their ageing fleet.

Decreased Exposure

IGO Ltd (-4.00%; Entry Short): An Australian nickel and lithium miner. The company's capital deployment into nickel has resulted in over $1bn being written off in just over a year while its investment in Greenbushes is under pressure as lithium prices fall to 2021 levels.

IDP Education Ltd (-3.75%; Entry Short): An international student placement and English testing provider. The company's total addressable market size is shrinking as English speaking Western countries tighten their immigration policy as housing shortages become a polarising topic in upcoming national elections.

Ramsay Healthcare Ltd (-2.00%; Long): A multinational private hospitals owner and operator. After initially showing signs of recovery earlier in the year, the margin pressure from higher input costs and inadequate private health insurance reimbursement has meant the company's turnaround progress is taking longer than expected.

Quarter-End Position & Portfolio Exposures

As at 30 September 2024, the Fund had net exposure of 94.9% and gross exposure of 192.8% to equities. Cash was 5.1%.

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

Stock Highlight: TechnologyOne Ltd (TNE) – Long Position

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

From Aus to UK – TechnologyOne's Growth Continues

The investment team has been monitoring TechnologyOne since the early 2000s, recognising its longstanding presence on the ASX. Initially, the company's attempts to expand internationally were not highly successful, yet its Australian operations continued to demonstrate robust growth, compounding at low to mid double-digit rates over 20 years, driven by high client retention and increased customer expenditure. Recently, we have identified another opportunity for medium-term growth that aligns well with their business model focused on consistent growth.

The UK market has traditionally been appealing for Australian companies due to its increased size and similar business environment. However, historical outcomes have been mixed, with companies like Wesfarmers, IRESS, and National Australia Bank experiencing significant challenges, while Lovisa, Premier Investments, and Breville have achieved remarkable success.

Despite initial struggles in the UK, TechnologyOne persisted with its expansion without materially impacting shareholder returns. The UK operations, which were at best break-even or slightly loss-making, saw stagnant revenues for years. It wasn't until FY23, following the strategic acquisition of Scientia in 2021, that sustained revenue and profit growth were achieved, providing a clear trigger for our investment case.

The increasing momentum in the UK, evidenced by consecutive years of profit growth and securing significant multi-year contracts with educational institutions, has strengthened management's confidence. This confidence was reflected in the recent investor presentation in July, where the Annualised Recurring Revenue (ARR) targets were revised upwards: from $500 million by FY26 to FY25, and now to 1H25, with a long-term goal of reaching $1 billion ARR by 2030. This goal seems attainable given their history of doubling in size roughly every five years. Additionally, the introduction and success of SaaS+, which commands a 40% premium over previous offerings, expanded the addressable market to $13.5 billion, further bolstering our confidence and leading to a sizeable overweight position in our long portfolio.

Although replicating the success of Lovisa or Premier Investments in the UK is not a certainty, the company has laid a strong foundation for potential growth in this market, mirroring the trajectory seen in its Australian operations. If the company maintains its double-digit growth and achieves its medium to long-term goals, it is reasonable to expect the share price to follow suit, reflecting this positive progression.

Australian Eagle
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Australian Eagle Trust - 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%	-3.92%	3.22%	3.75%	1.19%	3.22%	0.41%	-3.94%	-0.08%	0.74%	**4.58%**
2024/25	3.40%	-2.52%	0.17%										**0.97%**

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). You should consider the PDS prior to making any investment decisions. 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/p9iy-alr2783au.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.