

## Long-Short Quarterly Report – December 2016

### Portfolio Performance

As at 31 Dec 2016	3mth	6mth	Since Inception
Alleron Long-Short*	3.77%	14.58%	14.58%
S&P/ASX 100 Acc**	5.80%	10.99%	10.99%
RBA Cash Rate	0.38%	0.75%	0.75%

Performance figures are net of fees and expenses

\*Inception date is 1 July 2016

\*\* Performance benchmark

### Portfolio Commentary

The Alleron Long Short Portfolio produced positive returns for the December Quarter of 2016 returning just over 4% for the quarter before fees and 3.8% after all fees and charges. This takes Alleron's first 6 months of investment to just under 15% after accounting for all fees and charges.

After an extremely strong September Quarter performance the portfolio was more subdued. The long side of the portfolio continued to add positively to absolute performance. Strong contributions continued to come from resource companies, such as Fortescue and OZ minerals and related stocks like Monadelphous, as the global growth outlook began to turn positive thereby improving the outlook for commodity demand. This was offset by Sydney Airports where, despite continued strong traffic growth confirming our operational expectations, a specific issue led to share price weakness. Other long positions in industrial companies, such as Cochlear, Nanosonics and Treasury Wine Estates, that strongly outperformed the market in the September Quarter, went through a consolidation period in the most recent quarter.

The short side of the portfolio added positively to portfolio performance when compared to the overall market performance. Alleron held short positions in Sirtex Medical, Vocus Communications and TPG Telecom which all fell as announcements from respective management teams adjusted market expectations downward for each company's earnings growth for the coming year and indeed, called into question longer term expectations. The strongly positive contribution of the short portfolio offset the performance of the long side of the portfolio.

### Portfolio Highlights

#### Positives:

*Sirtex Medical Ltd* (Short) - The Company provided a trading update with sales impacted by recently launched competitors to its SIR-Spheres for liver cancer and restrictions in reimbursement. First half sales were downgraded to mid-single digit growth compared to expectations of double digit growth.

*Vocus Communications Ltd* (Short) – The FY17 trading update at the AGM weighed heavily on the share price due to the announcement of lower than expected earnings and customer cancellations at its recent Nextgen acquisition, calling into question the integration of the numerous acquisitions made by this business in recent years.

*OZ Minerals Ltd* (Long) - The share price rose mainly in conjunction with the price of copper. September quarter copper production rose 5% compared to June while C1 costs ended up at the lower end of guidance. Management gained confidence in the Carrapateena resource estimates as the project moves closer to board approval.

#### Negatives:

*Sydney Airport Holdings Ltd* (Long) – The Federal Government has given Sydney Airport 4 months to decide to fund Western Sydney airport by itself, which the company is reluctant to do. The share price also suffered from the recent increase in bond yields following the US election.

*Cochlear Ltd* (Long) – The share price fell due to the recent sell off in bonds. The Company's bright future prospects still remain intact with double digit FY17 profit growth guidance reaffirmed at the recent AGM.

*Incitec Pivot Ltd* (Short) – The Company reported FY16 EBIT declined by \$231m due to falling fertiliser prices. With fertiliser prices at cyclical lows and mining capex yet to recover, we are slowly reducing our short position.

### Australian Eagle Trust Long Short Fund Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2016							10.52%	0.99%	-1.08%	-4.14%	2.94%	5.16%	14.58%



## Market Overview

The Australian market rose as the big banks and miners outperformed. World markets performed strongly after Donald Trump's surprise president election victory in anticipation of his promised economic stimulus policies. The big banks' FY16 results all had increasing impairments of bad debts while keeping dividends steady. Woolworths sold its petrol station business to BP for \$1.8bn. ANZ sold its Asia retail and wealth businesses in order to focus on institutional banking in the Asia region. Blackmores had a first quarter trading update, warning of slower China sales in FY17 due to the impact of the recently imposed China import tax. Fortescue paid off another US\$1bn of debt from free cash flow, further highlighting its strengthening financial position. Henderson Group announced a merger of equals with fixed income manager Janus Capital Group.

## Portfolio Changes

### Stocks purchased:

*Ansell Ltd* (+3.00%; Closed Short): A health and safety protection solutions company. Funds were redeployed into new shorts.

*Japara Healthcare Ltd* (+1.50%; New Long): An Australian aged care provider. Previously announced government funding cuts were moderated which reinforce the Company's strong position in the industry.

*NextDC Ltd* (+0.75%; New Long): An Australian data centre operator. The company has successfully raised capital to potentially triple capacity in Brisbane, Melbourne and Sydney.

### Stocks sold:

*AMP Ltd* (-5.60%; Exit Long): A wealth management and financial institution. The company has been struggling for fund inflows and management has been slow to rectify problems in the wealth protection business.

*Boral Ltd* (-1.30%; New Short): A building and construction materials company. The company announced the acquisition of a large US construction company for \$3.5bn, increasing its debt by more than \$1 billion.

*TPG Telecom Ltd* (-2.00%; New Short): An Australian provider of retail and corporate telecommunications services. The company announced slowing profit growth in FY17 due to falling margins from wholesaling of NBN services.

## Quarter-End Position & Portfolio Exposures

As at 31 December 2016, the fund had a net exposure of 97.05% and gross exposure of 198.34% to equities. Cash was 2.95%.

Major portfolio exposures were to medical devices & services and resource stocks with less portfolio weight in major banks and retailers.

## Stock Highlight

### Treasury Wine Estates Limited (TWE) – Long Position

*Energy Argument:* TWE in its current form, was spun out of Fosters Group in 2011 and is the largest independent listed wine company in the world. Fosters created the company through purchasing and combining A\$6.5bn in acquisitions since it first bought Mildara Blass for A\$0.5bn in 1996. At the time of the Fosters purchase of the assets, EBIT margins were closer to 20% vs the 10% in 2014 and the EBIT margin per case of premium wine was said to be up to \$75/case. Alleron foresaw strong potential in the business at the time of purchase in 2014 due to the scale of the business, the sheer number of premium brands and clean balance sheet and the fact that the market was only valuing the enterprise at about A\$3bn.

*Trigger:* In 2014, TWE announced financial results that showed 35% growth in earnings from Asia at 40% margins. In perspective, TWE was earning 25% of its EBIT from less than 5% of its volume. Alleron entered the stock, highlighting the potential in Asia offering an avenue to return to historical margins and growth.

*Events since entry:* Alleron was slightly early with the purchase of TWE. During our holding period, the Company wrote down the US business and removed the CEO. Despite this, the Asian business still showed promise with growth also developing outside China.

The new CEO views the company as a suite of luxury brands, akin to that of the large European luxury brand houses. His target EBIT margins are closer to 20% than 10% and is flowing volume to the high margin Asian market, creating scarcity in traditional markets thereby confirming Alleron's original trigger. While the share price has now reflected some of the potential growth, earnings still has the potential to double from FY16 numbers should the CEO's plans be implemented in full.





### **About the Australian Eagle Trust Long-Short Fund**

Alleron is an Australian boutique wholesale fund manager specialising in Australian equities. Alleron'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 achieve strong double digit returns by allowing clients to access Alleron's demonstrated historical strength in constructing Australian share portfolios applied to a long-short product.

Modelling a combination of Alleron's actual long investment performance since 2005 in conjunction with a short selling discipline, suggests that this product can provide strong investment returns along with an alpha performance that is negatively correlated to the broader Australian equity market.

### **How to Invest**

The Australian Eagle Trust Long-Short Fund is only available to investors via the Australian Eagle Trust Information Memorandum that is available on [www.alleron.com.au/how-to-invest/](http://www.alleron.com.au/how-to-invest/). The Information Memorandum offers investors the opportunity to invest a minimum of \$500,000 in the Australian Eagle Trust (the Fund). Alleron has the discretion to waive or vary this minimum requirement.

The offer of units in the Fund are available to investors both resident in Australia and elsewhere receiving this document (including electronically) in Australia or elsewhere who qualify as "wholesale" clients as that term is defined in section 761G and 761GA of the Corporations Act. The Trustee may also accept applications from investors who are otherwise permitted to invest as permitted by the Corporations Act. Investors who are not resident in Australia can invest in the Fund where they are permitted by law to do so. The Trustee and Investment Manager of the Fund is Alleron.

*Disclaimer:* This communication is issued by Alleron Investment Management Limited ABN 71 109 874 160 AFSL 278856 Suite 301, Level 3, 100 Walker Street, North Sydney NSW 2060. This information does not constitute a recommendation, offer or solicitation to buy or sell any securities. It reflects Alleron's Portfolio at the end of the month stated and Alleron's views at the date of preparation. Both the Portfolio and Alleron's views are subject to change without notice. Past performance figures are no guarantee of future returns. Date of preparation: 14 January 2017.

