

Long-Short Quarterly Report – Jun 2017

Portfolio Performance

As at 30 Jun 2017	3mth	6mth	1yr	Since Inception
Alleron Long-Short*	3.65%	8.65%	24.48%	24.48%
S&P/ASX 100 Acc**	-1.70%	3.28%	14.62%	14.62%
RBA Cash Rate	0.38%	0.75%	1.50%	1.50%

Performance figures are net of fees and expenses

*Inception date is 1 July 2016

** Performance benchmark

Portfolio Commentary

For the 12 months ending June 2017, the Alleron Long Short Fund has returned +24.5% net of fees. The fund produced a strong absolute performance for the June Quarter of 2017 returning +3.65%.

After performing strongly over the first 3 quarters of the 2017 financial year, the market fell nearly 2% in the final quarter. The market falls were led by the big banks which were the target of government regulation on a number of fronts including capital restraint and new fee levies. Given Alleron's process of preferring significant positive change in earnings growth, which does not favour the largest companies in the market, the long side of the portfolio was not relatively impacted by these falls. The remaining stocks on the long side once again contributed the most to the portfolio performance. The Portfolio had a number of long favoured stocks, such as Cochlear and Treasury Wine Estates, hitting new highs as the market searched for both quality and earnings growth.

Despite the strength in the market, the Short side of the portfolio added to the overall performance. After hurting the portfolio in the March quarter, Alleron's maintenance of short positions in Vocus, Sirtex and TPG Telecom added in the June quarter of 2017. These gains were partially offset by market gains in short positions in Flight Centre and Boral. Late in the quarter Alleron closed its successful short position in Vocus after it received a takeover offer by private equity fund KKR.

Portfolio Highlights

Positives:

Cochlear Ltd (Long) - The Company reconfirmed its FY17 guidance of double digit profit growth supported by strong unit growth. The Company also acquired an audiology practice management software company to streamline patient care, enhance clinic efficiency and provide best practice processes.

Xero Ltd (Long) – The Company's FY17 result showed operating cash flow turned positive for the first time ever and Life Time Value increased from \$1.7bn to \$2.2bn. The Company's flagship product is gaining traction as total number of subscribers reached over 1m during 2H17.

Seek Ltd (Long) – The Company's Chinese subsidiary Zhaopin revealed 30% revenue growth for the March 17 quarter as it continues to dominate their local market. Management have also successfully privatised Zhaopin with a deal with 2 private equity groups.

Negatives:

Flight Centre Ltd (Short) – Despite the unprecedented and prolonged discounting in international air travel, the share price rose as the Company reaffirmed its FY17 targets of \$20bn total transaction value and \$300m-330m underlying profit before tax.

Fortescue Metals Group Ltd (Long) – The share price fell due to volatility in the iron ore price despite lower C1 production costs and a further US\$1bn of debt being repaid. The Company also announced innovation projects for FY18 which include an extra rollout of autonomous trucks to cut operating costs.

Boral Ltd (Short) – The share price rose in the quarter as management announced the completion of its earnings accretive Headwaters acquisition in the US. The Company also expressed greater confidence in achieving its FY17 guidance despite slightly lower US housing market growth rates.

Australian Eagle Trust Long Short Fund - Net Monthly Returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
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%



Market Overview

The Australian market fell as the big banks fell on concerns of overexposure to investor and interest only loans in the property market. Technology stocks experienced volatility on valuation concerns. Sydney Airport announced they would not build the Western Sydney Airport and also revealed plans for a Terminal 4. Sirtex reset their business with \$90m write off of intangible assets and a 15% reduction in employee headcount. Downer successfully acquired over 50% of Spotless, a listed catering and cleaning company. Treasury Wine Estates revealed more details of its imminent launch of a new French wine brand in China in the second half of 2017.

Portfolio Changes

Stocks purchased:

Elders Ltd (+2.25%; Long): An agricultural retailer and agency business. Management announced the completed divestment of the live export logistics business, allowing the Company to focus on the retail and agency businesses.

NextDC Ltd (+1.50%; Long): An Australian data centre owner and operator. The Company announced that its construction timeline for its new data centres has been fast tracked to open within 12 months.

Vocus Group Ltd (+4.00%; Closed Short): A telecommunications company. Private equity group KKR submitted an indicative non-binding proposal to takeover the company following the poorly executed integration of the former M2 and Vocus.

Stocks sold:

Telstra Ltd (-1.50%; New Short): An Australian telecommunications and technology company. Sustainability of its profitability and dividends have been questioned due to growing competition in the Australian broadband and mobile markets.

Harvey Norman Ltd (-2.75%; New Short): A home consumer products retailer and franchisor. The future profitability of the retail sector has been challenged by tightening credit conditions and the arrival of Amazon in Australia.

Domino's Pizza Enterprises Ltd (-1.75%; Short): A pizza franchise operator. The Company announced that the results of the industrial relations audit into underpayment of staff have been delayed. Franchisees have voiced concerns over potential cannibalisation of existing territory with the Company's franchise roll out plans.

Quarter-End Position & Portfolio Exposures

As at 30 June 2017, the fund had a net exposure of 95.92% and gross exposure of 194.30% to equities. Cash was 4.08%.

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

Stock Highlight

Xero Limited (XRO) – Long Position

Energy Argument: Xero is one of the only truly cloud based accounting software packages available for small businesses. The market reach is now extended through multiple continents and jurisdictions including the significantly larger UK and US markets. The founders of Xero, through their experience with founding competitor MYOB, developed a superior product that has taken the lion's share of the cloud-based accounting market in Australia and New Zealand. Further, the benefit of the cloud system is that it allows Xero to create an ecosystem of suppliers and clients and app store in which they are the hub and for which they manage the data which could be of tremendous value to the company.

Trigger: A trigger event may indeed be a single piece of information that grounds our thesis in reality. However, it may also be a mosaic of information that together has the same effect, as is the case with Xero. We initiated a position in the company in 2015 after it had demonstrated continued growth in customers to 593,000, and raised new equity to cover costs of growth. Further, National Australia Bank had also announced the linking of the bank's and Xero's data platforms to enable faster approval for business loans.

Outlook: When Alleron entered the stock, Xero had fallen over 70% from its share price high as expectations of the Company's growth exceeded its actual growth profile and certain management changes were considered disruptive. The execution of our triggers highlighted that the business momentum was intact. The first target for the company post its recent 1 millionth customer milestone is that of \$1bn in revenue. With the installed revenue base of about \$360m and +30% customer growth profile, the \$1b revenue base target is achievable. More importantly, should its growth in the UK be similar to that of Australia, it confirms management strategy and provides some confidence for US market growth.



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/. 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: 11 July 2017.

