It's all about change - the good and the bad; Monday Fundie

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Body

A bet on ***Fortescue*** when the iron ore miner was in deep trouble is one of the proudest moments of fund manager Sean Sequeira's career.

It was early 2016 and ***Fortescue*** had just posted its earnings result.

"Everyone thought it was going bankrupt," says the Australian Eagle Asset Management chief investment officer and portfolio manager. But Sequeira saw something that many of his peers had missed: strong cash flow and consistent progress in debt reduction. And all that was happening in spite of low iron ore prices, which were hovering at about $US39 a tonne.

"We thought the risks were overblown, and the opportunity was presenting itself for the potential upside on a world-class asset that the market was overlooking," he says.

Iron ore is now trading at $US106 a tonne.

Just as importantly, Sequeira, then deputy to chief investment officer Albert Hung, also noted the dramatic improvement in ***Fortescue***'s so-called C1 unit costs, the primary measure of expenses for an iron ore producer. They had fallen below that of mining giant BHP. For the investment team, this was the development they had been looking for. The fund scooped up the stock at $1.60 a share and the bet paid off.

Six years later, ***Fortescue*** stock climbed to $25. That's when Australian Eagle started to reduce its stake, and again in 2023, arguably too early, as ***Fortescue***'s share price hit $29.30 a year later.

Takeover target Altium was also a big moment in Sequeira's 30-year career. The fund had built a stake of more than 5 per cent in the company, which designs printed circuit boards used in electronics. The investment manager first bought the stock in 2017 at $11, emboldened by the "superb" 10-year track record of Altium's management team. Their new five-year business plan looked just as promising, with ambitious expansion into new markets planned.

Happily, a bigger player recognised that potential and took Altium out. Japanese semiconductor company Renesas Electronics offered $9.1 billion for Altium at $68.50 a share. The stock was delisted last year.

"Even in our best scenarios, we didn't come out with that type of price," recalls Sequeira.

Australian Eagle, which used to be Alleron, is a boutique investment manager focused on large-cap Australian equities. Its team of seven oversees $1.1 billion across a long-only fund and a long-short fund, meaning it can bet on share prices going down.

The fund's signature strategy is to identify signs of change in a business - good and bad - and anticipate what this means for earnings growth or quality.

"We want that improvement to be the thing that drives our investment returns and what will affect the company over the next three or five years," explains Sequeira. This means Australian Eagle typically holds a stock longer than its peers (it has owned hearing implant company Cochlear for more than 20 years). Investments typically start as a small position - 1 per cent - and build over time.

Likewise, when things look bad it's time to exit or even short the stock.

Australian Eagle will cut its losses and move fast when companies don't meet its expectations. "We get out relatively quickly because that means we don't know what's going on," Sequeira says.

The long-only strategy has a 20-year track record and returned 12 per cent before fees since inception, compared with the S&P/ASX 100 Accumulation Index's 8.4 per cent. The fund is only available to wholesale investors.

The long-short strategy, after fees, has returned 14.6 per cent a year on average, or 4.1 percentage points above the benchmark. As well as Cochlear, it owns QBE Insurance and Telix Pharmaceuticals.

A short bet on Paladin Energy and a long position in infrastructure investment company Infratil were among the biggest detractors in January.

In 2022, Australian Eagle partnered with Montgomery Investment Management to manage its Australian large-cap portfolios and distribute the Australian Eagle long-short fund to a broader set of investors.

Sequeira is bullish on property developer Dexus, and nuclear and silicon enrichment technology company Silex Systems. The stocks are among the portfolio's most undervalued companies, in his opinion, and a reason the fund increased its stake in both last month.

Sequeira expects big returns from Dexus should management execute its strategy of growing funds under management.

As for Silex, in which the fund holds a tiny position, Sequeira anticipates significant benefits should its laser technology be proven or adopted by the United States to counter Russian dominance in the sector.

In September last year, Sequeira sold Ramsay Healthcare shares after realising the company would not succeed as quickly as the fund hoped in a strategic turnaround. Australian Eagle had bought Ramsay shares on the belief that the private hospital operator would rationalise its asset base by selling assets in Europe. But when Ramsay's management team decided to keep them, the fund manager exited at $43.

"We started a small position that didn't work out according to our plan, and we got out at a small loss," says Sequeira, who bought in at $54 in 2023.

As chief investment officer, he has final say in all portfolio decisions.

Growing up in the western Sydney suburb of Pendle Hill, Sequeira wanted to be a petroleum engineer until he got a taste for financial markets working at Citibank after his year 12 exams.

Crossing over into investment management he was mentored by Hung, one of the founders of Australian Eagle and still a sounding board as chairman of the investment firm. Sequeira was part of the team that started out in 2005 with $15 million in seed money from St George Bank. This month, the fund celebrated its 20-year anniversary.

One of his biggest regrets is having sold out of software company Technology One too soon. He first bought the stock in 2006 at 70¢ and sold it at $1 in 2010, only to watch Technology One transform into a $10 billion company. Last year, Australian Eagle decided to buy back in at $16.50.

The team is still reviewing what it missed in the first run.

For Sequeira, selling too early is more painful than getting a stock wrong because the missed opportunity is more costly to portfolio performance than divesting at a small loss. "That's something you learn from," he says.

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