

# Quarterly Investment Review

31 March 2011

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OC Funds Deliver Strong  
March Quarter



## Market Report

The Australian equity market delivered another month of positive returns with S&P ASX 200 Accumulation Index closing March up 0.7%. This was an admirable performance from the market in the context of the global events that transpired during the month, particularly in Japan and the Middle East/North Africa.

As a result of the uncertainty that these events created, the market took the opportunity to “de-risk” during the month and this was illustrated no more clearly than in the relative movements of the ASX Small Industrials Index +0.6% and the ASX Small Resources Index -2.4%.

As mentioned above, global factors were the dominant force in the Australian market during the month, again reminding investors that the Australian economy and the domestic equity market should never be considered in isolation to the rest of the world. The devastating earthquake and ensuing tsunami in Japan (which precipitated a nuclear emergency) shook Japanese markets and the impact reverberated throughout Asia and the world at large. Civil unrest (indeed, civil war in the case of Libya) in the Middle East and North Africa was the other dominant geo-political factor at play during the month which had markets on edge.

These events were coupled with ongoing concerns around European sovereign debt, the potential slowing of the Chinese economy and oil prices spiking up firmly above the US\$100 level leading many to have second thoughts about the ongoing global economic recovery (particularly in the US).

By and large, international markets managed to recover some of the lost ground late in the month and we saw the leading benchmarks turn in reasonable returns in the broader context of global events including the US S&P 500 +0.1%, the UK FTSE -0.8% and the HongKongHangSeng +0.7%. Understandably Japan was not able to recover toward breakeven levels and the Nikkei finished the month -8.2%.

The Reserve Bank of Australia continues to hold rates at 4.25%. Investors will recall the RBA moved to this level on Melbourne Cup day 2010 and the recent data leads us to believe it could be well into the second half of 2011 before the RBA again feels prompted to move on rates.

Merger and acquisition activity gave way to equity raisings (notably Origin’s \$2.3b rights issue) and block trades (Carsales.com - \$566m & Sundance - \$191m) during the month. On top of this, market chatter continued to swirl around potential corporate transactions in the likes of Austar and Woodside whilst the AXA/AMP tie-up was finally consummated late in the month.

OC Performance*	1 Mth	3 Mths	6 Mths	1 Yr	3 Yrs	5 Yrs	Since Incep
OC Premium Fund	4.0%	7.4%	16.9%	18.6%	4.1%	-0.8%	11.2%
S&P/ASX Small Inds Accum	1.4%	2.2%	7.8%	5.8%	-3.2%	-2.1%	5.0%
Added Value	2.6%	5.2%	9.1%	12.8%	7.3%	1.3%	6.2%
OC Dynamic Fund	2.6%	6.5%	17.4%	18.8%	4.6%	-0.3%	12.6%
S&P/ASX Small Inds Accum	1.4%	2.2%	7.8%	5.8%	-3.2%	-2.1%	5.2%
Added Value	1.2%	4.3%	9.6%	13.0%	7.8%	1.8%	7.4%
OC Concentrated Fund	1.5%	3.5%	25.5%	28.2%	29.6%	14.2%	17.4%
S&P/ASX All Ords Accum	0.7%	2.9%	8.4%	4.8%	1.2%	3.6%	10.6%
Added Value	0.8%	0.6%	17.1%	23.4%	28.4%	10.6%	6.8%

\*Performance figures are based on the hard close unit prices as at 31/03/2011



## OC Premium Fund

The Premium Fund finished the month up 4.0% taking the quarterly return to a robust 7.4%. This was well ahead of both the Small Industrials Accumulation Index which was up 2.2% for the quarter and the Small Ordinaries Accumulation Index which was down 1.2% for the quarter. The Premium Fund is up 18.6% over the past year which is significantly ahead of the Small Industrials Accumulation Index which is up 5.8%.

Once again, the key driver of the strong Fund performance was a consistent return across our core portfolio holdings whilst minimising the number of stocks that materially detracted from overall performance. As mentioned in the February monthly review, our investment approach of investing in relatively simple and domestically focused businesses and maintaining regular contact with company management and their competitors paid dividends for us when most of our stocks released results in line or slightly in excess of market expectations in the February reporting season. Several of these stocks continued to re-rate during March including **REA Group** and **Ausdrill Ltd** which drove strong portfolio returns.

In addition, a number of stocks that have been added to the portfolio over the past month have been stand-out performers namely **Village Roadshow**, **Decmil** and **Global Construction Services** which all added 15%+ during March.

Village Roadshow (VRL) has been a good performer since being added to the portfolio in late February having appreciated by in excess of 40% (including an 8 cent dividend and 12 cent special dividend). The stock had long been screened out of our process due to its complex capital structure, excessive debt burden and poor corporate governance track record. The catalyst for inclusion was the simplification of the corporate structure including the conversion of the preference shares to ordinary stock and the significant reduction in the company's debt levels brought about by the sale of Sydney Attractions and the takeover bid for **Austereo** (52.2% owned by VRL). Significantly VRL management has re-engaged with institutional investors and made several concessions to improve the governance of the company and attract investor interest. Additionally, VRL recently announced that it intends to pay a capital return of around \$1 per share once it receives an obligatory tax ruling. Notwithstanding

the strong share price performance, the stock still looks fundamentally undervalued trading on a 2012 PE of less than 10 x post the capital return.

Decmil (DCG) and Global Construction Services (GCS) are both exposed to the buoyant resource led WA economy and have very strong project pipelines and earnings trajectories. DCG provides design, civil and engineering services to the resources, energy and infrastructure sectors whilst GCS is a construction and maintenance services company. Both companies are well managed and have a proven track record of delivering on earnings forecasts. Both stocks have re-rated over the past month following investor roadshows which focused on the large project opportunities in the WA market over the coming few years.

Fortunately, there were few stocks that hurt the portfolio in a meaningful way during the quarter. **Sirtex Medical** was down 12% but posted a solid interim result and there was no fundamental reason for the decrease in the share price. We remain comfortable with this holding.

## OC Dynamic Fund

The Dynamic Fund finished the month up 2.6% taking the quarterly return to 6.5%. The Dynamic Fund is now up 18.8% over the past year which is a pleasing result for investors.

A key trading position in **Maryborough Sugar** performed strongly during the quarter having benefitted from a firm sugar price and speculation about potential corporate activity from Thai based 19.9% shareholder Mitr Phol Sugar Corp. On the flip-side, we were somewhat disappointed that the Board of IT solutions company **Bravura Solutions** knocked back rumoured takeover bids from four separate suitors at a share price in excess of \$0.25. The stock price fell back to \$0.19 impacting the March performance. We have held onto the position as we remain confident that the company is in the early stages of an operational turnaround and that a higher takeover bid will emerge in time.



## OC Concentrated Fund

The Concentrated Fund was up 1.5% in March bringing the quarterly return to 3.5%. The Fund performed slightly ahead of the All Ordinaries Accumulation Index which was up 0.7% in March and 2.9% for the quarter. The Concentrated Fund is now up 28.2% over the past 12 months versus the All Ordinaries Accumulation Index which is up just 4.8%.

Once again, all three components of the Concentrated Fund (Core Fundamental, Emerging Leaders and Alpha Plus Trading) added value over the quarter.

In the Core Fundamental section of the portfolio, the Fund benefitted from the strong performance of holdings in **Global Construction Services**, **Automotive Holdings** and **Ausdrill** (which are all held in the OC Premium and OC Dynamic Funds as well).

The best performing stocks in the Emerging Leaders section of the portfolio included:

- Aluminium products group, **Capral Ltd**, was up 47% from our recent entry price of \$0.22. The company has delivered a \$19m operational turnaround on what has essentially been a flat market, with recent initiatives around cost and supply chain delivering a 36% reduction in breakeven volumes. Trading on 3.2 x EBITDA and sitting on net cash (\$11m) the stock remains good value.
- **Skywest Airlines** was up 30% for the quarter following the announcement of a 10 year strategic alliance with Virgin Blue Group to create a regional network. The company continues to benefit from increasing demand from mining companies for fly-in/fly-out services particularly in regional Western Australia.


The Alpha Plus section also profited from a number of successful trades during the quarter including **Atlantic Ltd** which finished the quarter up 25% and **Pluton Resources** which was exited at a 50% profit. The Fund is down on its **Indophil Resources** position, which fell 35% during the quarter, after San Miguel failed to lob an widely expected takeover offer for the company.

## Outlook

The Australian equity market has held up well recently in the wake of a raft of major offshore events including the turmoil in Libya and the Japanese earthquake and tsunami and the subsequent nuclear emergency. Following a sharp sell-off in mid March, the market has rebounded strongly as investors once again focused on the strong underlying fundamentals of the Australian market. Valuations continue to look reasonable, corporate profits are improving and the domestic economy remains solid underpinned by a very strong resources sector.

We have spoken on numerous occasions over the past six months about the 'two speed' domestic economy and little has changed on this front. The housing sector and the consumer discretionary space remain tough although interest rates now appear to be on hold, at least in the short-term, following the impact of the floods in January, and this should allow some level of confidence to return. Our recent contact with retailers, including incoming Premier Investments Managing Director Mark McInnes and Chairman Solomon Lew, indicates that retail trading conditions continue to be tough and are not expected to improve until later in the calendar year. Our key retail exposures of **Breville Group**, **Super Auto Group** and **Kathmandu** continue to perform very well operationally and have enjoyed strong re-ratings in recent months. We exited our position in **JB Hi-Fi** after the stock rallied strongly following the announcement of an off-market share buy-back for up to 10% of the shares on issue.

Companies exposed to the resources boom continue to have a strong outlook underpinned by buoyant commodity prices and the ramp up of major new projects. The coming months should see Financial Investment Decision (FID) being made on a number of very large resource projects including Chevron's Wheatstone LNG project and Woodside's Pluto II LNG project. The portfolios currently have a number of companies that stand to benefit from a pick-up in activity in the resources space including **Mineral Resources**, **Campbell Brothers**, Decmil, Global Construction Services, Ausenco and Ausdrill. Notwithstanding this strong outlook, we have been vigilant to trim positions as they approach our valuations and, to this end, we have recently reduced our holdings in Campbell Brothers despite its very strong outlook.



From a global perspective, the US economy continues to slowly improve although we will be closely monitoring the impact of the surging oil price which has breached US\$100 per barrel and shows no sign of slowing down. The sensitivity of the US economy to the oil price is well documented and may impact on growth in the second half of the year should it continue to trade around or above these levels. Also of interest will be the impact of the end of the US Federal Reserve's \$600m bond buying program (widely known as QE II) which has undoubtedly been supportive of equity markets to the extent that it helped to restore consumer and investor confidence. The key question is whether the US economy will be sufficiently strong going forward to stand on its own two feet without further monetary or fiscal support. At this stage, the answer to that question is unknown.

The Chinese continue to raise interest rates in an effort to cool inflation before it sets in. Although their economy is slowing slightly, they seem to be winning this battle for the time being. We believe that the Chinese Central Government is doing a very good job of managing their economy which augers well for Australia given that China remains our biggest export customer and the powerhouse that is underpinning the global commodities boom.

At present, the one year forward price-earnings (PE) of the Small Industrials Index is 12.3, a 5% discount to the long-term average. This is not onerous in the context of the economic outlook and we continue to believe that now is a good time to invest and that our existing investors will be well rewarded over the coming 12 months.

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## Fund Holdings<sup>^</sup>

	OC Premium	OC Dynamic	OC Concentrated
Largest Holdings*			
Increased			
Reduced			

**Fund holdings only available to OC unitholders**

\* Largest holdings in alphabetical order.

## Fund Stats

	OC Premium	OC Dynamic	OC Concentrated
Contributions			
Positive			
Negative			

**Fund holdings only available to OC unitholders**

<sup>^</sup>If you are an OC Fund unitholder, please contact us directly if you would like a complete list of Fund holdings.

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Fund holdings only available  
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\* Past performance is not a reliable indicator of future performance. The Total Returns of the OC Funds over specified periods are shown in the above table. This table contains information regarding Total Returns to 31 March 2011. Total Returns are calculated after taking into account performance fees. Where OC Funds generates a return on The Premium and Dynamic Funds over and above the performance hurdle of 15% in any financial year, a performance fee of 20.5% of all profits above this level is charged to the Funds directly. Where OC Funds generates a return on the Concentrated Fund over and above the performance hurdle of 0% in any financial year (subject to a high water mark), a performance fee of 10.25% of all profits above this level is charged to the Fund directly. Between 1 July 2004 and 30 June 2009 where OC Funds generated a return on the Concentrated Fund over and above the performance hurdle of 0% in any financial year (subject to a high water mark), a performance fee of 20.5% of all profits above this level was charged to the Fund directly. Before 1 July 2004, performance fees were not paid out of the Funds but billed by OC Funds directly to investors. In this table, the Total Returns for the period prior to 1 July 2004 have been adjusted to reflect the paid performance fees as if the fees were paid out by the Funds. The Total Return performance figures quoted are historical, calculated using end of month mid prices and do not allow the effects of income tax or inflation. Total Returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The Indices do not incur these costs. This information is provided for general comparative purposes. Positive returns, which the Funds are designed to provide, are different regarding risk and investment profile to index returns.

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