

# Monthly Fund Update

31 August 2011

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*Australia Well Positioned Against  
Global Backdrop*



## OC Premium Equity Fund

August reporting season was a month of extreme volatility largely driven by macro shocks (sovereign debt related) emanating from the Euro zone. There were few major surprises in our portfolio during the month and the OC Premium Equity Fund finished the month down 3.5% versus the Small Industrials Accumulation Index which fell 2.2%.

Most of our core positions reported earnings in line with, or above, our expectations. But very few were rewarded by share price appreciation in a 'risk-off' environment where many investors, frightened by macro news out of Europe and the US, reduced their allocation toward equities, and in particular small cap names, in favour of the safety of cash.

**Ausenco** delivered an interim result in line with market expectations but surprised many by providing bullish FY11 and FY12 earnings guidance and the stock rallied off its intra month lows to finish 10% higher for August (and +35% off its absolute lows). Ausenco is a late cycle capex play and with staff utilisation levels back to pre GFC levels, employee numbers steadily increasing and a strong pipeline of projects we are confident that the stock will perform strongly over the coming 12 months.

**Service Stream** delivered a very strong FY11 result, highlighted by exceptional cashflow, and investors accordingly pushed the stock higher in an otherwise choppy market. Service Stream was subsequently awarded a material NBN contract in early September which, along with follow on contracts and associated works, should see the business growth trajectory continue.

**Cash Converters** finished the month on 12 month lows after the federal government proposed new regulations in its payday lending business and its suitor, EZCORP, subsequently withdrew its proportional bid for the company. Whilst we trimmed our position at higher levels, at current prices (6x FY12 PE), we believe the stock represents good value given the likelihood of substantial watering down of current proposed regulations.

**CSG's** full year result was in line with consensus expectations but driven by a low tax rate. The market subsequently ticked the stock down 15% due to the perception of the result being "low quality". The company's cash flow improved significantly in the fourth quarter and it appears well positioned to win some major contracts in IT services in coming months. As such, we believe the stock is too cheap at present levels and, together with short-medium term catalysts, we expect to see it trading higher in the coming months.

OC Performance	1 Mth	3 Mths	6 Mths	1 Yr	3 Yrs (p.a)	5 Yrs (p.a)	Since Incept	Since Incept
OC Premium Equity Fund	-3.5%	-8.3%	-10.0%	8.6%	0.9%	-4.4%	9.3%	159.1%
S&P/ASX Small Inds Accum	-2.2%	-5.7%	-7.2%	4.5%	-3.8%	-3.9%	3.9%	50.7%
Added Value	-1.3%	-2.6%	-2.8%	4.1%	4.7%	-0.5%	5.4%	108.4%
OC Dynamic Equity Fund	-4.5%	-9.5%	-12.4%	8.2%	1.1%	-4.0%	10.4%	188.5%
S&P/ASX Small Inds Accum	-2.2%	-5.7%	-7.2%	4.5%	-3.8%	-3.9%	4.1%	54.3%
Added Value	-2.3%	-3.8%	-5.2%	3.7%	4.9%	-0.1%	6.3%	134.2%
OC Concentrated Equity Fund	-4.4%	-12.2%	-15.7%	12.5%	19.4%	9.5%	13.7%	169.9%
S&P/ASX All Ords Accum	-2.0%	-7.6%	-9.3%	2.6%	-1.6%	1.2%	8.5%	88.3%
Added Value	-2.4%	-4.6%	-6.4%	9.9%	21.0%	8.3%	5.2%	81.6%

Fund Inception Dates: OC Premium Equity Fund 08/12/2000. OC Dynamic Equity Fund 20/12/2000. OC Concentrated Equity Fund 30/11/2003.



## OC Dynamic Equity Fund

The OC Dynamic Equity Fund was down 4.5% in the month of August. The under-performance versus the OC Premium Equity Fund during the month was largely due to two Emerging Leaders holdings, namely **Allmine Group** and **G8 Education**.

Allmine Group drifted lower during the month despite announcing a solid result and a positive update on its projects. We attribute this to general market conditions impacting a smaller market capitalisation stock; many of these types of stocks were sold down during the month on low trading volume. The business is well exposed to the booming minerals sector and has a strong relationship with China Nonferrous Metal Industry's Foreign Engineering and Construction Co. which is providing a strong pipeline of projects to underpin FY12 earnings.

G8 Education continues to be hampered by the ongoing dispute regarding its recent Singapore acquisition. We understand a positive outcome in relation to this matter is forthcoming and the market will soon be able to refocus on the quality of the business model rather than other distractions.

## OC Concentrated Equity Fund

The OC Concentrated Equity Fund finished August down 4.4%, underperforming the All Ordinaries Accumulation Index which finished the month down 2.0%. The smaller cap bias of the portfolio undoubtedly impacted performance relative to the market as small cap stocks drifted lower on soft volumes in an uncertain macro-economic environment.

In the **Core Fundamental** section of the portfolio, the Fund's winners in Service Stream (strong result further evidencing the business turnaround) and Ausenco (strong full year guidance delivered at interim result) were more than offset by disappointments from the likes of CSG Group and **M2 Telecommunications**. Additionally **Mineral Resources**, **Gerard Lighting** and **Automotive Holdings** all traded lower despite solid results.

In the **Emerging Leaders** section of the portfolio, Allmine and G8 Education (both mentioned above) lead the portfolio lower.

The **Alpha Plus** section of the portfolio performed broadly in line with the market with no stocks standing out at either end of the spectrum. We believe this part of the Fund remains well positioned to benefit from short term market opportunities (on both the long and short side).

Investors should be aware that the Fund composition, and hence performance, is not directly correlated with the market and this is one of the reasons that the Fund is able to generate substantial outperformance for investors in most markets.

## Outlook

Risk aversion remains at elevated levels on imminent fears that Greece is about to default on its debt. This, along with concerns about a slowing US economy, is the key reason why equities have been sold off aggressively in recent weeks. The market's worst case scenario is that a Greek default in turn sets off other defaults across Euro zone periphery in nations such as Ireland, Portugal, Italy and Spain that, in turn, would trigger losses to the banks holding the debt and lead to adverse impact on the Euro zone/global financial markets and economies. As we have mentioned previously, this is the key reason why most of the companies in our portfolios have little or no gearing. We do not expect that any of our holdings will face debt refinancing issues should debt markets deteriorate further and credit be rationed.

This is a worst case scenario but there are a number of other complex financial and political scenarios that are more likely to play out in Europe in the coming weeks. The reality is that the outcome is uncertain and that a coordinated policy response will be required to avert a Euro zone crisis that is increasingly being priced into global equity markets. Nevertheless, for now, the uncertainty means that equities may continue to drift lower driven by risk aversion.

The good news is that a domestic rate rise would now appear to be off the agenda, particularly given the recent increase in unemployment from 5.1% to 5.3%. Unlike the Europeans or the US, Australia still has a number of policy weapons at its disposal and very low levels of national debt so it is extremely well positioned to respond to any crisis or deterioration in economic conditions.



Importantly from Australia's perspective, China continues to power ahead with economic growth of around 9% fuelling the commodities boom which continues to underpin the domestic economy. A recent China visit by two of OC Fund's non executive directors confirmed our confidence in the medium term growth outlook for the country and our belief that Chinese policy makers are winning the battle to tame inflationary pressures. This is very good news for the Australian economy and our equity market.

The key for investors in an environment such as this is not to panic. Many of our core investments are not dependent on a strong economic environment for growth and irrational selling in a crisis such as this tends to throw up outstanding long-term investment opportunities.

As investors, it is difficult to pick the bottom of any market trough but any positive news flow when sentiment is so bearish will have a disproportionately positive impact on markets. This was witnessed at the depths of the GFC from which equities rebounded strongly.

We have recently added **Navitas**, a quality education provider with defensive qualities and excellent cashflow generation, to the portfolio. We have long liked the company and its proven management and the recent share price pull back has offered an attractive entry point. There are several other similar opportunities to purchase quality stocks at discounted prices and we expect to use our solid cash holdings to selectively enter some of these names in the coming weeks.

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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 August 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. This document is for general information purposes only and does not take into account the specific investment objectives, financial situation or particular needs of any specific recipient. As such, before acting on any information contained in this document, recipients should consider the appropriateness of the information to their needs. This may involve seeking advice from a qualified financial adviser. OC Funds (ACN 092 872 056) is the issuer of the OC Premium Equity Fund (ARSN 098 644 976) ('Premium Fund') and the OC Dynamic Equity Fund (ARSN 098 644 681) ('Dynamic Fund'), and the OC Concentrated Fund (ARSN 126 537 424) ('OC Concentrated Fund'). Current PDS's are available from OC Funds, located at Level 33, 360 Collins Street, Melbourne, VIC 3000, (03) 9602 3199. A person should consider the PDS's before deciding whether to acquire or continue to hold an interest in the the OC Premium Fund, the OC Dynamic Fund or the OC Concentrated Fund. Any opinions or recommendation contained in this document are subject to change without notice and OC Funds is under no obligation to update or keep any information contained in this document current. OC Funds holds AFSL no.229316.