FUNDS MANAGEMENT

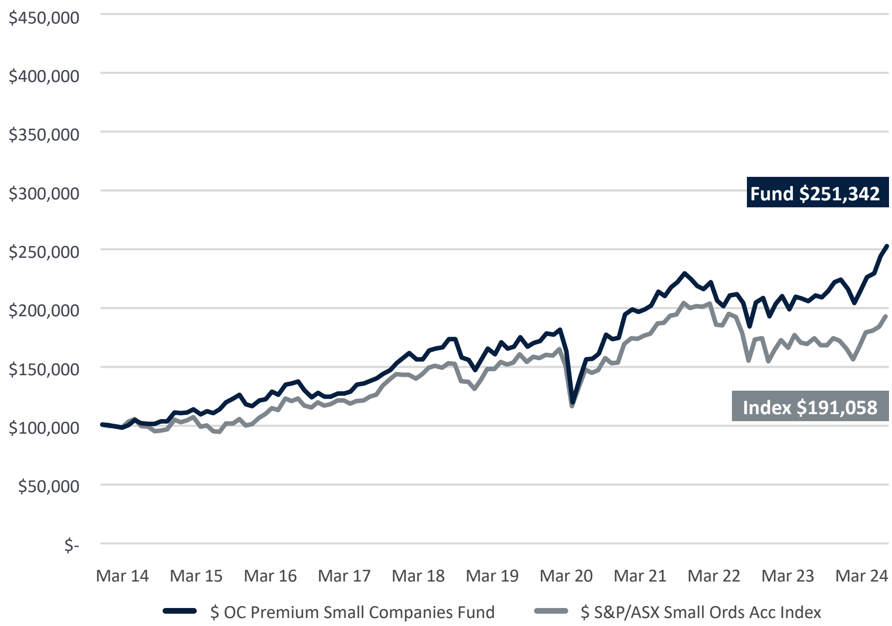
OC Premium Small Companies Fund
Fund Update | 31 March 2024

11.7%
Fund up 11.7% for the quarter

7.8%
Returned 7.8% p.a. for the past 3 years

We remain confident the Fund will continue to deliver attractive long-term returns

Performance comparison of $100,000 over 10 years*



Total returns

At 31 March 2024†	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.	Incep % . p.a. (Dec 2000)
OC Premium	3.6	11.7	22.8	7.8	9.6	9.7	10.8
S&P/ASX Small Ords Accum	4.8	7.5	13.8	2.7	5.4	6.7	5.9
Outperformance	**-1.2**	**4.2**	**9.0**	**5.1**	**4.1**	**3.0**	**4.9**
S&P/ASX Small Ind Accum	3.5	9.6	20.5	1.7	4.9	6.7	6.1
Outperformance	**0.0**	**2.1**	**2.4**	**6.1**	**4.7**	**3.0**	**4.7**

The total return performance figures quoted are historical, calculated using end-of-month net asset value per unit after fees and do not allow for the effects of income tax or inflation

Performance review

The domestic small-cap equities indices strengthened into the start of the new calendar year with confidence and liquidity beginning to return to the space after a protracted downturn. Whilst the reporting season across small cap companies was overall mixed, the Fund's holdings, on balance, reported stronger results than the market which allowed us to comfortably outperform the small-cap indices during the quarter. The OC Premium Small Companies Fund finished the quarter up 11.7% which was well ahead of the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which were up 7.5% and 9.6%, respectively, for the quarter.

The OC Premium Small Companies Fund has navigated the challenging macro-economic environment of the past three years relatively well posting a return of +7.8% per annum. This is well ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which have returned +2.7% and +1.7% per annum, respectively, over the same time horizon.

Life360, Inc. (360, +73.2%) surged higher in March after the release of its CY23 result beat market expectations and management also outlined a step change in strategy, and earnings growth potential, through the introduction of a new advertising revenue stream. Long term Fund holding 360 delivered full year revenue of US$304.5m, which was comfortably within its guidance range, but surprised the market to the upside by posting adjusted EBITDA of US$20.6m, some 28% ahead of the top end of guidance. Year end cash of US$70.7m was also comfortably ahead of market expectations as were most key metrics including US Average Revenue Per Paying Circle (US$150) and Annualised Monthly Subscription Revenue (US$274m). The strong CY23 result was accompanied by upgraded CY24 guidance, but the market was truly excited by the announcement of a new advertising model, the revenues of which 'could match subscription revenues' overtime, according to management. Given the many years the advertising model is expected to take to gain full traction, and the expected ongoing growth of the existing subscription revenue business over this same period, the injection of advertising revenues into the Life360 app is seen as a potential game changer for the company. Whilst it is still very early in the 360 'advertising' journey, we are excited by the growth on offer in this key holding in the Innovator Sleeve of the Fund we look forward to updates on this opportunity over the balance of CY24, which could prove to be a pivotal year for the company.

Enterprise networking services provider **Megaport (MP1, +62.9%)** was a strong contributor during the quarter following the release of its 2Q update in January, followed by its interim FY24 result, which each delivered profitability and cash flow metrics ahead of market expectations. Whilst still in the early stages of a turnaround, we have been encouraged by the progress made to date by new CEO, Michael Reid, and his team. Mr Reid is an experienced tech sales executive, having spent much of his career at US networking giant, Cisco, and having most recently served as Chief Revenue Officer at the Cisco owned ThousandEyes. Following a rationalisation of its cost base in FY23, MP1 has made a significant re-investment in its direct sales team during the last few quarters which we expect will eventually drive a re-acceleration in its sales pipeline and growth. We also expect recent upgrades to its network, and the rollout of new products and contract types should be supportive of driving greater uptake of services by existing and new clients. MP1, through its 'software defined network', provides businesses with a flexible solution to connect multiple data points (such as public cloud, private cloud) to each other via a flexible and easy to use interface. With the demand for data connectivity continuing to grow driven by the proliferation of cloud computing, and more recently through the adoption of Artificial Intelligence, we see MP1 as a key beneficiary of this structural trend over the medium to longer term.

GQG Partners Inc (GQG, +33.0%) again found itself on the positive side of the ledger this quarter with continued strong fund inflows across its four main equity products and excellent investment performance driving earnings momentum for the business. GQG manages around US$143.4 billion in funds across four primary equity strategies. The new calendar year has started well for GQG from a fund inflow perspective with US$4.6 billion raised by the end of March. GQG's recent investment performance has fortified the business's outstanding long-term performance track record and ought to help it continue to attract solid fund inflows which are currently averaging around US$1.0 billion per month.

In mid-March, GQG announced the launch of its new Private Capital Solutions business, its first foray into private markets. GQG concurrently agreed a deal whereby it will acquire Pacific Current Group's (PAC) interest in three boutiques, namely Avante, Cordillera and Proterra, and will assume external management of the remaining PAC boutiques for a management fee of 0.75% of the fair value of those boutiques interests, excluding cash. The new division will be co-led by PAC CEO/CIO Paul Greenwood, who is well known and regarded by OC Funds, and will employ various other PAC staff. The Private Capital Solutions business will undertake investment in alternative asset managers, initially using GQG's balance sheet and, over time, external capital. GQG intends to utilise its quality in-house distribution team to raise capital for investee managers.

Despite the strong share price in the March quarter, GQG is currently on a PE multiple of just 11.3x one-year forward consensus earnings and offers an attractive 8.3% (unfranked) dividend yield. We believe that GQG can continue to outperform, particularly if management undertake a small stock sell down which ought to enable the stock to gain inclusion in key equity indices, such as the S&P/ASX 200 Index. We think that this could be a material catalyst for the stock to rerate.

Transit and tourism operator **Kelsian Group (KLS, -16.3%)** saw a reversal of recent gains during the quarter after reporting materially higher interest and depreciation costs than the market was expecting. KLS operates predominantly public bus and ferry routes for governments in Australia, Singapore and the UK, corporate contracted services in the USA plus a selection of tourist assets in Australia. At an operating level, the EBITDA performance of KLS was largely as expected, but this was not enough to stop the inevitable trimming of consensus valuations brought about by the financial adjustments (below the EBITDA line).

While frustrated by the downgrades, which could have been better communicated to the market, the news was not all bad given that the labour headwinds in the Sydney and Singapore public bus operations have abated, and the recently acquired US bus operations appear to be tracking ahead of the guidance given at the time of acquisition. While the contracted bus operations all have cost passthrough or indexation to protect margins, KLS had been experiencing a shortage of bus drivers, particularly in central Sydney and on Singaporean routes, which led to higher overtime, missed punctuality bonusses and some contract penalties, not covered by the indexation of labour in the contracts. With the workforce now on a normal footing, the company is expecting to revert to a more usual margin profile in these operations. The US bus operations opportunistically purchased 40 additional diesel buses from a large tech client who is electrifying their fleet. These buses are expected to be deployed into service for new and expanded clients elsewhere in the US network to bolster future growth. In addition, the company has formed a special purpose vehicle for funding buses on Australian government contracts which is likely to reduce the cost of debt and go some way to offsetting the impact of term debt renewals in the current high interest rate environment.

Outlook

Global growth continues to moderate, although falling inflation, robust jobs markets and a resilient consumer has tempered recessionary fears. Expectations of a soft landing in key economies such as the US and Australia are now the consensus view, as are interest rate cuts in the back half of the year, the caveat being that inflation will need to continue to moderate further for central banks to begin the easing cycle.

The February reporting season, and subsequent management meetings, has kept the OC investment team busy in recent weeks. According to the Goldman Sachs strategy team 32% of small ordinaries constituents beat consensus estimates whilst 46% fell short. This is better than historical averages and a marked improvement from the past two years. The sell-side is usually overly exuberant with their forecasts in small-caps, but they were closer to the mark than usual in February. Cost out was a highlight across the small companies' space, with solid cost control in many instances cushioning the impact of a slowing top line and inflationary pressures. The UBS strategy team suggested that a third of companies releasing results indicated that cost pressures have now passed peak intensity, which bodes well for the coming 12 months.

In the US, a combination of solid economic growth, low unemployment and falling inflation remains consistent with a soft landing playing out. US economic growth remains solid and at its late March meeting the US Federal Reserve (the Fed) slightly upgraded both its growth and inflation forecasts. The Fed has stuck with its guidance of three lots of 25 basis point rate cuts this year, which are expected to commence as soon as June. They did emphasise that the projections are not a predetermined plan, and that the individual forecasts are subject to change based on incoming data for inflation and the labour market. With strong recent March jobs data indicating that the US economy had added 303,000 jobs during March (the unemployment rate dipped to 3.8%), this week's US inflation print will be closely scrutinised. Further confirmation that services inflation remains sticky would likely derail the likelihood of near-term rate cuts in the US, an outcome that would clearly be a negative for equities, in particular growth stocks.

In Australia, the economy is cooling more rapidly. Gross Domestic Product (GDP) expanded by a tepid 0.2% in the December quarter, or 1.5% on an annualised basis. Strong net migration has cushioned the slow-down but, adjusting for population growth, Australia remains mired in a 'per capita recession'. The squeeze from higher interest rates on household incomes and discretionary spending is delivering an economic slowdown, and consumer spending is slowing. Two key data prints late in the quarter have nevertheless tempered prior expectations of rate cuts before the back end of the year with the unemployment rate unexpectedly dropping to 3.7% in February (well below consensus expectations of 4.0%) and headline inflation holding steady at 3.4% for a third consecutive month in February. Services and non-tradables inflation remain elevated and trimmed mean inflation, the Reserve Bank of Australia's (RBA) preferred measure of price changes, rose slightly to 3.9% in February from 3.8% according to the Australian Bureau of Statistics (ABS). Whilst the economy is slowing, it will be difficult for the RBA to cut rates until the labour market eases, and inflation resumes its trajectory towards the 2-3% target band. As a result, the Fund remains underweight domestic cyclical exposures, many of which staged relief rallies during the quarter.

Over recent months, we have added several quality companies to the portfolio which have strong secular growth drivers and topped up existing positions where our conviction in their outlook has strengthened. An important focus at present remains on investing in quality business models at reasonable valuations that ought to have resilient earnings in a slowing economy. From a macro perspective, we think that margin pressures are likely to continue for cyclical businesses, despite inflation moderating, which increases the appeal of quality (profitability and low leverage) for investors.

The Fund has made several investments into companies poised to benefit from the widespread adoption of Generative Artificial Intelligence (GenAI) which we believe presents a significant investment opportunity. We are entering a period of rapid technological advancement driven by adoption of GenAI which is expected to become ubiquitous, impacting every business and industry. Whilst the ASX lacks the high profile AI behemoths like Nvidia and Microsoft, the portfolio has several holdings exposed to this secular tailwind including data centre operators NEXTDC and Macquarie Technology Group. The development of AI, digitisation of businesses, the development of technologies such as Internet of Things, and machine learning is expected to generate huge demand for data storage and analysis, which translates directly into the demand for data centres, cloud, and co-location services. The Fund is well positioned to benefit from this megatrend through its holdings in businesses with quality data centre operations which include NEXTDC, Macquarie Technology Group and Infratil Limited (through its 42% investment in CDC).

Post our reporting season management catchups, we will once again head out on the road with an extensive company visitation program planned in the coming two months. We thank our investors for their ongoing support and remain committed to our goal of generating strong long-term risk-adjusted returns for our clients.

Top 5 holdings#

Company	ASX code
GQG Partners	GQG
HMC Capital Limited	HMC
Kelsian Group Ltd	KLS
Mineral Resources	MIN
Seven Group Holdings	SVW

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments.

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† The total return performance figures quoted are historical, calculated using end-of-month hard-close mid-prices and do not allow for 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 index does not incur these costs. This information is provided for general comparative purposes.

* The performance comparison of $100,000 over 10 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Small Ordinaries Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.