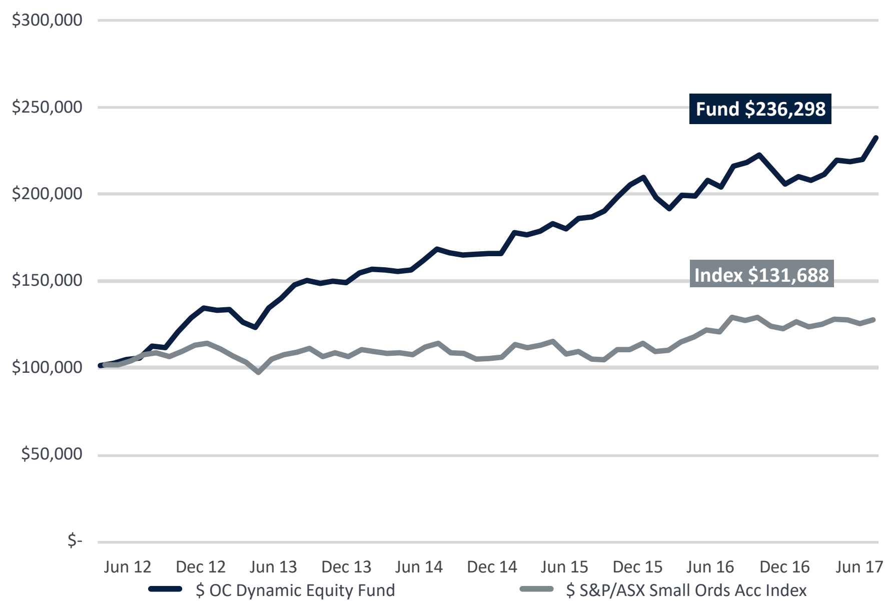
OC Dynamic Equity Fund
Fund Update | 30 June 2017

6.0% Fund up 6.0% for the quarter

18.8% Returned 18.8% p.a. for the past five years

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

Performance comparison of $100,000 over 5 years*



Total returns

At 30 June 2017	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Incep. % p.a. (Dec 2000)
OC Dynamic	5.9	6.0	14.4	14.6	18.8	16.6	5.0	12.9
S&P/ASX Small Ords Accum	2.0	-0.3	7.0	7.1	5.7	3.9	-1.9	5.5
Outperformance	**3.9**	**6.3**	**7.4**	**7.5**	**13.1**	**12.7**	**6.9**	**7.3**
S&P/ASX Small Ind Accum	2.4	0.1	7.9	9.2	11.4	9.9	0.6	6.2
Outperformance	**3.5**	**5.9**	**6.5**	**5.4**	**7.4**	**6.7**	**4.4**	**6.7**

Performance review

June was a strong month for the OC Dynamic Equity Fund which finished up 5.9%, capping a solid quarter in which the Fund returned +6.0%. This was well ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which returned -0.3% and +0.1% respectively for the quarter.

This capped another strong period of outperformance for the Fund which finished the financial year up a robust 14.4%. This was well ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which finished the year up 7.0% and 7.9%, respectively.

Despite the continued solid performance, we remind investors that there are likely to be periods where we may underperform the benchmark over the short term. Nevertheless, we remain confident our strong and disciplined investment process can continue to deliver robust investment returns over the long term. It is for this reason we encourage investors to invest over at least a five-year investment cycle, preferably longer.

The Fund’s long-term track record remains excellent having returned 18.8% p.a. over five years. This is well ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which are up 5.7% p.a. and 11.4% p.a. respectively over the same time horizon.

There was plenty of news flow in the domestic small-cap space which moved the needle in the June quarter, notwithstanding the low volatility that persisted across global equity markets. In particular, earnings downgrades from a number of small companies weighed on the small-cap index, continuing the trend discussed in our May report. PMP, Gateway Lifestyle, GR Engineering, Retail Food Group and Ardent Leisure all guided the market to lower earnings for the financial year in the month of June. Fortunately, the Fund suffered only one negative earnings revisions during the June quarter (Apiam, AHX -38.6%), a factor which undoubtedly helped our strong relative performance.

Appen Limited (APX, +50.6%) - the speech and search technology company continued its strong re-rating in June with the stock up a further 12.0% for the month following its material earnings upgrade in May. Despite the quantum of the upgrade (EBITDA is now expected to be 40-50% above CY16, up from previous guidance of mid-to-high teens EBITDA growth), we see further scope for earnings upgrades over the balance of the calendar year based on the current order book and the strong operating momentum across the business. APX counts nine of the world's 10 largest technology companies as clients and continues to add new clients and increase margins. APX is well placed to continue to benefit from the rise of machine learning, as well as voice-based technologies and remains a core portfolio holding for the Fund.

a2 Milk Company (A2M, +38.2%) – announced its second guidance upgrade for the quarter in mid-June as it continues to evolve from a branded Australian and New Zealand liquid milk company to become a global nutrition company. The company again highlighted that demand for its a2 Platinum Infant Formula product had exceeded expectations and noted it had been working closely with its infant formula manufacturing partner, Synlait Milk (SM1, +27.2%), which is also held by the Fund, to uplift the production schedule for the remainder of FY17. Clearly increased production augurs well for further growth into FY18, particularly in the Chinese market where the company continues to rapidly grow its market share.

Updater, Inc. (UPD, +39.7%) – US-based technology company, UPD, enjoyed a strong quarter as the broader market becomes more comfortable with the value of the platform. UPD offers home movers a service to complete tedious and time-consuming tasks efficiently (such as updating/changing address) and at the same time allows businesses to communicate with these consumers in a timely manner. This opportunity for businesses to effectively market to consumers during the moving process is considered highly valuable as people tend to make important, long-term decisions when they are moving house (for example, around choosing insurance products and utility providers). UPD is growing its market penetration of the US mover market with its last published benchmark at +9%; but we would currently estimate penetration to be well north of 10% and growing rapidly with a CY17 target of 15%.

During June, UPD announced the signing of a pilot program with US behemoth, AT&T. AT&T is the world's largest telco and one of the largest listed corporations in the US with a market capitalisation of approximately US$237b. It has a leading position in the US fixed-line telephony market and also in subscription TV (cable), broadband internet and mobile. We estimate AT&T has the second largest marketing budget in the US and is among the top 10 advertisers globally. For a company of AT&T's size and complexity, to sign a pilot program with UPD is a strong endorsement of UPD's platform. With further updates on market penetration and pilot programs expected over the balance of CY17, we remain excited by the future prospects of Updater.

Baby Bunting (BBN, -5.6%) and **Super Retail Group (SUL, -20.0%)** – both fell victim to the Amazon effect during the quarter which is spooking many investors in traditional retail businesses. Talk about Amazon's impending entry into Australia was considerable over the quarter, both in the print media and in myriad sell-side analyst reports, many of which attempt to quantify what Amazon's entry will ultimately mean for Australian retailers. We do not doubt Amazon's entry will have a material impact on the domestic retail landscape, nor do we dispute both BBN and SUL will need to evolve to compete with the e-commerce giant. We do however believe each of these businesses have qualities that position them well to withstand the inevitable Amazon entry.

SUL is a category leader in each of its three divisions, being auto (Supercheap Auto), leisure (BCF, Rays) and sport (Rebel, Amart Sports) with a national store footprint, an emerging private brand offering, an agile and efficient supply chain, multi-channel capability and a highly regarded management team. BBN is the clear sector leader with a store roll-out strategy that will not only see its footprint double over the medium to long term, but has also actively put its bricks and mortar competitors out of business due to its compelling prices and range. Rigorous Australian standards in relation to baby products mean Amazon will need to source most of its inventory in Australia which limits its ability to leverage its global buying power. Strong service levels and in-store experience both feature highly on why consumers shop with these retailers.

We believe BBN and SUL are well positioned in the face of the inevitable Amazon entry into Australia. The share price of both companies began to recover in June, with BBN up 11.8% and SUL up 6.5% for the month. Both remain undervalued on our analysis and we used the share price weakness during the quarter to increase our holdings in both companies.

G8 Education (GEM, -11.5%) – it was an eventful quarter for the childcare centre operator after Chinese-backed, CIGF Investment Partners International (CIPI), failed to settle its second tranche payment on its $149m share subscription agreement; capital which is necessary for GEM to execute on its subsequently announced strategic growth plan. The company undertook a hastily organised placement at $3.20 to fill the void which, although at a material discount to CIPI's prior commitment at $3.88 per share, nevertheless leaves the business fully funded to deliver on its 49 development centres, pay down its existing debt and potentially assist in securing a club bank facility in the near term. As part of this process, GEM issued a trading update which was well received by the market (EBIT on track to meet the consensus range of mid-high $170m), despite a 3.4% decline in occupancy (rolling 12-month basis) and some slippage in the acquisition pipeline. The Fund had reduced its position in GEM back in March (above $4.10 a share) on valuation grounds and we used the placement to once again increase our holding now the stock is significantly de-risked from a balance sheet perspective. The GEM share price re-rated strongly in June (+7.1%) and it is now well funded to execute on its clearly articulated growth strategy.

During the quarter, the Fund exited both **IDP Education (IEL, +10.7%)** and **Altium (ALU, +12.8%)** after strong share price performances as they reached our valuation targets. We also exited our holding **Ardent Leisure (AAD, +2.7%)** in April when speculation around corporate activity involving Ariadne drove the share price higher. Our exit proved to be well timed after AAD released an operational update in late June that suggested its critical Main Event business in the US continues to report negative constant centre like-for-like growth in the fourth quarter.

Recent IPO, **Bingo Industries (BIN, +2.8%)**, was a key addition to the portfolio during the quarter. BIN is a leading waste management and recycling company operating primarily in NSW. The company is a vertically integrated operator having capacity across the waste collection, processing, separation and recycling components of the waste value chain. BIN's high recovery rates in post collections is a key competitive advantage with rising environmental awareness, increasing landfill costs and EPA regulations all key drivers of growth. Although we are typically reluctant participants in the IPO market, we were impressed with BIN's highly motivated and aligned management team, impressive IT systems and quality operations, which we visited during our due diligence process.

We are forecasting strong double-digit earnings growth for BIN over the coming years driven by a number of factors including: a) organic growth in collections with the NSW commercial and industrial and building and demolition sectors expected to grow at around 3% over the next three years, b) organic growth in post collections driven by increasing utilisation at BIN's well-positioned network of nine resources recovery and recycling centres in NSW, c) further margin expansion driven by reduction in tipping and transport costs from increased recycling capacity, increased internal processing and changes in commercially agreed disposal rates, and d) further acquisitions including geographical expansion into the fragmented Victorian market which looks ripe for consolidation. We believe the current FY18 multiple of 8.9x FY18 EV/EBITDA or 15.5x PE is an attractive entry point and that there is significant scope for BIN to re-rate in time as the market gains confidence in the quality and growth prospects of the business.

Apiam Animal Health (AHX, -40.2%) – the production animal health business was the worst performer in the portfolio during the quarter. Despite having exposure to various favourable industry thematics, AHX has not yet been able to capitalise on its market-leading position. It disappointed the market with soft earnings guidance in May, including blow-outs in systems implementation budgets, and we have lost confidence in management's ability to execute on what we consider to be a sound business strategy around consolidating the leading industry players in the sector. As a result, we have exited our position until we see concrete evidence the business is back on track.

Outlook

Domestic economic conditions remain mixed heading into the new financial year, a view reiterated by the Reserve Bank of Australia (RBA) at its July meeting when it left interest rates steady at 1.5% for a tenth straight meeting. A soft household sector, ongoing low growth in wages and concerns about the persistent Australian dollar strength are preventing the RBA from joining a growing offshore central bank shift toward interest rate normalisation. Interestingly, the RBA dropped any reference to its 3% GDP growth forecast at its meeting and conceded the recent slowing in GDP could only be partly attributed to temporary factors.

In a positive development for the consumer discretionary space, the monthly retail sales report exceeded expectations for the second consecutive month, with a +0.6% month-on-month increase ahead of consensus expectations (+0.2%), lifting the annual growth rate to a solid 3.8%. Clearly this is a positive for Fund holdings Super Retail Group and Baby Bunting Group and is consistent with our recent channel checks which suggest retail conditions have bounced off the bottom.

In contrast to Australia, the outlook for the global economy remains optimistic with major global economies, including the US and China, showing signs of ongoing strength as the global economy enters the new financial year with its best growth momentum in several years. In China, growth is being supported by increased spending on infrastructure and property construction, with the high level of debt continuing to present a medium-term risk. The US outlook is being clouded somewhat by political inertia which is stalling the proposed implementation of tax cuts and infrastructure spending which would support above-trend growth. US growth momentum, nevertheless, remains solid led by a consumer rebound, an uptick in capital spending and a labour market at full employment. The US Federal Reserve continued its path towards monetary policy normalisation, hiking rates for the third time in five meetings in June and reiterating plans to deliver another increase by the end of 2017.

The situation in North Korea remains a key downside risk and has the potential to snap the market out of its low volatility comfort zone as tensions on the Korean Peninsula rise further. In one of its most audacious moves yet, North Korea successfully tested an intercontinental ballistic missile in early July in what amounts to a major provocation, not the least because the rogue state now appears to have a missile capable of hitting Alaska at the very least. It remains to be seen how the US will respond, but the stakes have been raised and the North Korean nuclear threat for the US is more real now than ever before. In terms of direct portfolio positioning, there are no immediate implications for the OC portfolio. But it is does provide a cautionary offset to the strong global economic outlook and warrants some degree of caution given this situation could escalate into a war very quickly.

IPO activity hit a brick wall in May and the month of June continued that trend with Red Rooster franchisor, Craveable Brands, joining a number of recent high profile prospective IPOs such as Wesfarmers spinning out Officeworks, hydro-tap company Zip Water and pub operator, Dixon Hospitality, being pulled from the market after failing to excite fund managers with its price expectations. IPOs being pulled can be frustrating as our due diligence process at OC Funds is comprehensive and we conducted multiple management and analyst meetings and undertook site visits for each of these IPO candidates. Nevertheless, we consider the discipline of passing on overpriced stocks or saying ‘no’ to businesses that fail to reach our qualitative thresholds is just as important in generating strong long-term investment returns as much as it is in picking good quality stocks that appreciate in price.

Interestingly, corporate activity has begun to accelerate, particularly in the private equity space, with private equity firms stepping into the void left by cautious fund managers and buying both **Zip Water** and **Dixon Hospitality**. Many private equity funds are cashed up and the low interest rate environment is conducive to deal-making in this space. No doubt there are some nervous boards planning defence strategies following disappointing operating performance in recent times.
It has been a busy quarter for the investment team which has mostly been spent out of the office and interstate visiting the management of fund holdings, conducting site visits or undertaking due diligence on potential new investments. July provides some welcome respite as we enter the blackout period for companies with either June 30 or December 31 financial year ends. This effectively means that communication from companies to investors is limited to non-financial matters until the release of results in August.

We would like to thank our investors for their ongoing support and wish them all the best for a prosperous 2018 financial year. We enter the new year confident our stocks are performing well operationally and that we can continue to deliver strong long-term returns for our investors.

Top 5 holdings#

Company	ASX code
The a2 Milk Company	A2M
Bapcor Limited	BAP
Blue Sky Limited	BLA
Super Retail Group Ltd	SUL
Webjet Limited	WEB

CONTACT COPIA

1800 442 129 | clientservices@copiapartners.com.au | copiapartners.com.au

John Clothier	General Manager, Distribution	0408 488 549 | jclothier@copiapartners.com.au
Adam Tweedale	State Manager, Southern Region	0425 804 727 | atweedale@copiapartners.com.au
Angela Vincent	State Manager, Northern Region	0477 347 260 | avincent@copiapartners.com.au
Sean Paul McGoldrick	Account Manager, Northern Region	0421 050 370 | spmcgoldrick@copiapartners.com.au
Iain Mason	Director, Institutional Business	0412 137 424 | imason@copiapartners.com.au
Jacinta King	Business Development Associate	0413 962 922 | jking@copiapartners.com.au

*The performance comparison of $100,000 over 5 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. There is no guarantee these objectives will be met.

#The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments. The securities listed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.