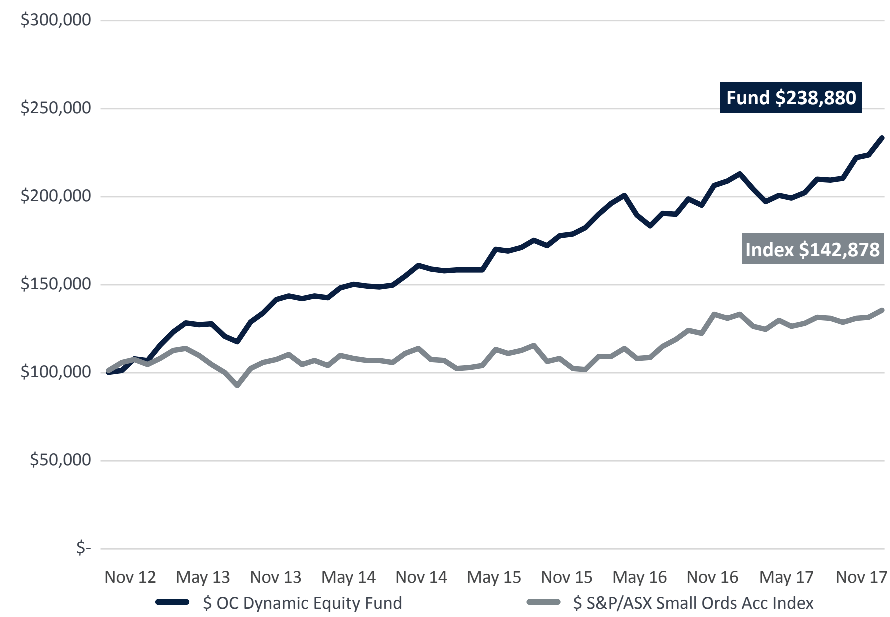
OC Dynamic Equity Fund
Fund Update | 30 November 2017

1.3% Fund up 1.3% for the month

19.1% Returned 19.1% 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 November 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	1.3	6.7	26.9	16.7	19.1	15.9	6.2	13.3
S&P/ASX Small Ords Accum	3.9	11.6	20.5	13.4	7.4	3.1	-0.6	6.3
Outperformance	**-2.6**	**-4.9**	**6.4**	**3.4**	**11.7**	**12.8**	**6.8**	**7.0**
S&P/ASX Small Ind Accum	2.8	10.0	18.4	12.0	12.3	9.7	2.0	6.7
Outperformance	**-1.5**	**-3.3**	**8.5**	**4.7**	**6.8**	**6.3**	**4.2**	**6.6**

Performance review

The Australian small-cap market continued its strong finish to calendar year 2017 with the S&P/ASX Small Ordinaries Accumulation Index up 3.9% and the S&P/ASX Small Industrials Accumulation Index up 2.8%. This was ahead of the OC Dynamic Equity Fund which was up 1.3%. The resources sector again led the way with the S&P/ASX Small Resources Index up a further 8.1% in November, taking its financial year-to-date gain to 26.5%.

The prevailing mood in small caps remains ‘risk-on’ particularly in the commodity space where the lure of fast returns and a fear of missing out seems to be driving the price action in some of the more speculative resource names, many of which are not yet in production let alone turning a profit. We do however acknowledge there is a strong structural growth story underpinning some of these stocks, particularly in ‘new energy’ commodities such as cobalt, lithium, graphite and nickel, where commodity-price momentum has been driven by the rise of electric vehicles and emergence of energy storage devices such as lithium-ion batteries.

The Fund’s long-term track record remains strong with a five-year annualised return of 19.1% p.a. This is comfortably ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which are up 7.4% and 12.3%, respectively, over the same time horizon.

Speedcast International (SDA, +24.5%) - performed well during the month as it announced a number of business development wins and as the market became more comfortable with an improving outlook for the Energy Division driven by a buoyant industry backdrop. Speedcast is a provider of end-to-end remote communications and IT solutions utilising a network of satellites/teleports to ensure connectivity for a global customer base operating in industries such as offshore oil rigs and maritime shipping (including cargo and cruise ships). We visited the SDA Energy business in Houston during our recent tour of the US and from our meeting it became apparent the business has stabilised after challenging recent conditions on the back of depressed oil prices. The business has now booked three quarters of consistent service revenue and, combined with an improving macro environment (oil price ~ US$60, increased offshore drilling tendering activity), we have renewed confidence that the division can return to organic growth in CY18. SDA appears to have timed the recent acquisition of Harris Caprock in the energy space to perfection with green shoots starting to appear. On top of this renewed optimism in the Energy Division, SDA announced business developments across a variety of sectors, including a:

- multi-year contract with the Australian government's Antarctic Research Stations providing remote communication services
- partnership with the US government in response to the Puerto Rican hurricane relief efforts, and
- strategic alliance with the European-based, market-leading marine IT and communications business, SRH Marine.

These developments further demonstrate SDA's global reach and capability and we believe SDA is well positioned to achieve solid organic growth across each of its energy, maritime, enterprise and emerging markets and government divisions in the coming years.

We visited Speedcast's Energy Division in Houston on our recent tour of the US – the business has stabilised with a positive outlook from a stronger industry backdrop.

Appen Limited (APX, +32.2%) - the speech and search technology company operating in the field of artificial intelligence announced the earnings-accretive acquisition of Leapforce, a US-based competitor, for US$80m. Leapforce, like APX's content relevance division, specialises in search relevance through a highly automated and proprietary end-to-end technology platform. The deal makes compelling strategic sense as the businesses are highly complementary and will further diversify APX's customer base. Leapforce has a well-regarded technology platform that is scalable and will be implemented across APX, which ought to improve efficiency and ultimately reduce cost. APX's 400,000 on-demand global crowd of contractors will benefit from the addition of Leapforce's own crowd numbering around 800,000. At a time of rapid industry growth, the Leapforce acquisition ought to provide scale and a base load of worker supply for the growth opportunities that lie ahead. The acquisition is expected to deliver at least 35% underlying EPS accretion on a FY17 pro forma basis (pre-synergies, transaction costs and share-based payments) and the growth outlook for the combined entity continues to strengthen. We subscribed for stock in the placement undertaken to fund the deal and APX remains a core holding in the Fund.

To provide some context to investors on the growth opportunity for Appen's content relevance division, it is worth considering an extract from an article posted by the CEO of YouTube recently in the UK:

"In the last year, we took action to protect our community against violent or extremist content, testing new systems to combat emerging and evolving threats. We tightened our policies on what content can appear on our platform, or earn revenue for creators. We increased our enforcement teams. And we invested in powerful new machine learning technology to scale the efforts of our human moderators to take down videos and comments that violate our policies.
Now, we are applying the lessons we've learned from our work fighting violent extremism content over the last year in order to tackle other problematic content. Our goal is to stay one step ahead of bad actors, making it harder for policy-violating content to surface or remain on YouTube. Human judgment is critical to making contextualised decisions on content.

Human reviewers remain essential to both removing content and training machine learning systems because human judgment is critical to making contextualised decisions on content. Since June, our trust and safety teams have manually reviewed nearly 2 million videos for violent extremist content, helping train our machine-learning technology to identify similar videos in the future.

We will continue the significant growth of our teams into next year, with the goal of bringing the total number of people across Google working to address content that might violate our policies to over 10,000 in 2018.

We will use our cutting-edge machine learning more widely to allow us to quickly and efficiently remove content that violates our guidelines. In June we deployed this technology to flag violent extremist content for human review and we've seen tremendous progress…

Because we have seen these positive results, we have begun training machine learning technology across other challenging content areas, including child safety and hate speech."

Leapforce is the largest provider of reviewers to YouTube and Google and is a major provider of the human moderators who are educating the machine-learning systems to improve the quality of their output. Other major technology companies such as Facebook, Amazon and Microsoft similarly engage Appen and Leapforce to address the concerns around bad actors on their platform and this ought to continue to be a strong growth area for the combined entity in the coming years.

Bingo Industries (BIN, +12.7%) - key portfolio holding BIN undertook a $120m entitlement offer during the month, the bulk of which will be used to acquire the highly complementary National Recycling Group (NRG, $51.1m) and the Patons Lane Recycling Centre & Landfill (Patons Lane, $30.0m). When BIN listed, a key rationale was to access capital to fund strategically sensible acquisitions which would expand their network capacity and offer the potential for margin enhancement through cost and synergy extraction. NRG augments BIN's vertically integrated waste management business in NSW and increases its exposure in the rapidly expanding western suburbs of Melbourne, which coupled with the three recent Victorian acquisitions, now gives BIN a strong foothold in the fragmented Victorian market. Patons Lane, on the other hand, allows for full NSW vertical integration. The regulatory landscape of Queensland landfill levies, post the recent election, remains unclear and we view BIN's move to open its own landfill to handle internally generated volumes as strategically sensible. The site is due to become operational in FY20, when BIN forecasts it to generate ~$20m EBITDA (pre-synergies) and even under a scenario of no Queensland levy and NSW disposal prices remaining unchanged, capturing landfill margin would likely be value accretive for the BIN business.

The Managing Director, Dan Tartak, and his family members each subscribed for their full rights entitlement in a strong endorsement of the deal. We have met with BIN management many times since its May 2017 listing, including undertaking visits with them, and they are undoubtedly one of the more passionate, driven and aligned management teams we have encountered in recent years. BIN is now well positioned to execute on the strategic vision it articulated at the time of the IPO. BIN shares continue to trade at a discount to peers, despite its recent solid share price performance, and it is a key holding in the Fund.

Webjet (WEB, -17.6%) - was the key disappointment for the month after the company released EBITDA guidance of $80m at its AGM, which was below market consensus and our own forecast of circa $86m. The key disparity versus our expectations arose within the Asian 'web-beds' business FIT Ruums where WEB now expects to deliver losses in line with FY17 ($3.3m) compared to previous guidance for FY18 of break-even. Clearly this has been construed negatively by the market, but management considers the size of the growth opportunity in Asia sufficient to warrant additional investment at the expense of near-term profits. This is a vexed issue that often faces management of listed growth businesses, namely should they forego investment for future growth prospects in order to allow them to hit near-term earnings forecasts. If one was to be critical on WEB's management, you would to say their engagement with the analyst community around guidance was poor. A number of items called out at the November AGM (including a $1.2m one-off JacTravel acquisition cost, an ongoing "Netflix tax" impact on Online Republic (-$1.7m in FY18) and an additional $2.7m of costs incurred by Thomas Cook) could have been made clearer at the time of the FY17 result in August when these items ought to have been largely known. Compounding matters, management indicated the seasonality of the B2B business, inclusive of JacTravel, will result in a negative H1 FY18 cash flow that will reverse in H2. Having modelled the business, including the JacTravel acquisition (bought at peak working capital levels which then unwind), this is a logical outcome, albeit not something the market will warmly embrace in the near term.

We generally take a dim view of an unexpected operational earnings miss yet we have opted to retain our position in WEB despite this being somewhat of a second strike, with WEB having fallen foul of its auditors a few months earlier (a dispute now resolved). Why is this? First, the revised guidance still implies solid double-digit underlying growth, despite considerable investment in the B2B business. Furthermore, both the B2B and B2C businesses appear to be growing well above industry growth rates. Management has executed well in recent years and while its messaging to the market has been sloppy of late, the stock has materially de-rated. From a valuation perspective, WEB now looks cheap (FY19 PE of 14.9x and FY20 PE of 11.4x), particularly relative to peer valuations and we see significant upside in the coming years.

*We visited **BlueSky**'s US real estate JV, Cove Property Group's Hudson Yards development at 441 Ninth Avenue in New York. The building is being refurbished from an 8 storey industrial space to a modern 17 storey office tower in a revitalised part of the city near Penn Station.*

Outlook

The December festive season often brings with it an opportunity for your humble investment team to celebrate at various broker, company or client Christmas parties, which invariably involve the myriad experts in attendance proffering their views on all things equities, including the likely performance of the benchmark over the coming calendar year.

As seasoned sceptics fortified by 50+ years of market experience including the 2000 'tech wreck' and the GFC, it has struck us that universal consensus at these events more often ends up being unequivocally wrong. There can be a number of logical explanations for this, not the least being that a lot can happen in markets over 12 months and much can change including black swan events which are, by definition, impossible to foresee. However, where the masses are overwhelmingly bullish (or bearish as may be the case) the logical reason that markets often fall (or rise) is that much of the good (bad) news that is expected to drive the indices going forward is already priced into the market which is typically forward looking. As such, risk, looking forward, becomes asymmetrically skewed to the downside (upside) given these already lofty (bearish) expectations.

Having said all this, while the mood over the Christmas pudding this year has been overwhelmingly optimistic about the coming 12 months, there is undoubtedly much to be upbeat about from a macro-economic perspective.

Conditions in the global economy remain robust with major global economies, including the US and China, showing signs of ongoing strength. Synchronised global economic growth, combined with low inflation and low interest rates, has strengthened investors' conviction the global equity rally will continue to grind higher.

In the US, which remains the most influential driver of the global business activity, the current cycle has plenty of legs with corporate earnings continuing to surprise on the upside and the US private sector (driven by households) still running a cash-flow surplus as we enter the ninth year of economic expansion. US tax reform should be a catalyst for improved US earnings and has been a driver of recent market optimism.

In China, growth is being underpinned by increased spending on infrastructure and property construction which, in turn, is fuelling commodity price rises which is good for both resource companies and Australia's national accounts. In a sign of increased global optimism, the IMF recently upgraded its global growth forecast for the first time in six years.

We are carefully monitoring how central banks approach their monetary policy settings as 'cheap liquidity' has been a major driver of asset valuations including equities. We see central banks gradually unwinding their QE programs and reducing the size of their balance sheets over the medium term, although we do not expect them to raise rates rapidly in the short term, which ought to be supportive of equity markets.

Conditions in the domestic economy remain more balanced although recent economic data has certainly had a more positive bias. Non-mining business investment remains strong and the labour market is strengthening, although the lack of real wages growth and high consumer debt levels are constraining consumer spending.

A soft household sector, ongoing low growth in wages, inflation below trend and concerns about the persistent Australian dollar strength are preventing the RBA from joining a growing offshore central bank shift to rate normalisation.

The east coast housing market appears to have peaked, particularly in Sydney, with out-of-cycle rate hikes and macro-prudential tightening finally starting to impact.

The RBA's confidence in a non-mining investment recovery appears to have strengthened recently which corresponds with our view that east coast infrastructure spend will increase significantly over the coming few years, particularly in areas such as road, rail, transport, telecommunications and renewable energy.

The outlook for mining capex has also improved, with project-related activity having bounced off its lows and lead indicators, such as heavy equipment sales and utilisation levels, also improving.

Generally, many of our peers talking at the Christmas punch bowl expect GDP growth to bounce to around 3% short term and the overwhelming consensus on the domestic economy is a mood of cautious optimism that conditions are getting better.

The obvious shortcoming of assessing the stock-market's outlook purely by reference to economic and political factors is that it ignores the valuation equation, and this a common mistake we see all too often. One would be hard pressed to argue that equities look cheap by any traditional valuation metrics. But that is not to say that stocks cannot sustain elevated valuations for some time to come given interest rates remain very low by historical standards and are unlikely to rise rapidly any time soon.

While we may lack the unbridled enthusiasm of some of our contemporaries that a broad-based global rally will lift all boats in CY18, we are confident our disciplined investment approach can continue to generate solid returns for our investors. We believe our portfolio has a spread of quality businesses trading at a discount to fair value and that investors with patient capital will be rewarded over the medium to long term.

Top 5 holdings[#]

Company	ASX code
Appen Limited	APX
Bapcor Limited	BAP
Bingo Industries Ltd	BIN
Speedcast Ltd	SDA
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.

Past performance is not a reliable indicator of future performance. The total return performance figures quoted are historical, calculated using end-of- month 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 indices do not incur these costs. This information is provided for general comparative purposes. Positive returns, which the OC Dynamic Equity Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. Total returns are calculated after taking into account performance fees. Where OC Funds Management generates a return on the OC Dynamic Equity Fund 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 Fund directly. 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 reader. As such, before acting on any information contained in this article, readers should consider the appropriateness of the information to their needs. This may involve seeking advice from a qualified financial adviser. Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) is the issuer of the OC Dynamic Equity Fund (ARSN 098 644 681). A current PDS is available from Copia located at Level 25, 360 Collins Street, Melbourne Vic 3000, by visiting ocfunds.copiapartners. com.au or by calling 1800 442 129 (free call). A person should consider the PDS before deciding whether to acquire or continue to hold an interest in the Fund. Any opinions or recommendation contained in this document are subject to change without notice and Copia is under no obligation to update or keep any information contained in this document current.