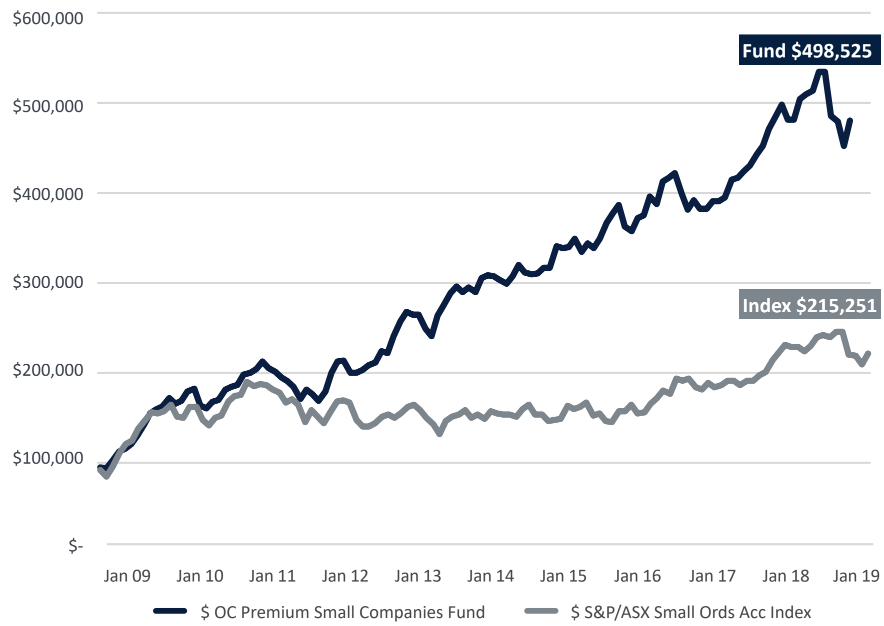
OC Premium Small Companies Fund
Fund Update | 31 January 2019

6.3% Fund up 6.3% for the month

17.5% Returned 17.5% p.a. for the past ten 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 January 2019†	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 Premium	6.3	-0.9	-0.6	9.8	10.6	15.0	17.5	11.1
S&P/ASX Small Ords Accum	5.6	0.8	-3.1	11.3	7.4	4.5	8.0	5.7
Outperformance	**0.7**	**-1.7**	**2.5**	**-1.5**	**3.3**	**10.5**	**9.5**	**5.4**
S&P/ASX Small Ind Accum	4.9	1.6	-1.5	8.3	8.0	10.2	11.0	6.1
Outperformance	**1.4**	**-2.5**	**0.9**	**1.5**	**2.6**	**4.9**	**6.5**	**5.0**

Performance review

Following a challenging quarter across global equity markets, equities bounced strongly in January and the OC Premium Small Companies Fund returned a robust 6.3% for the month. This was ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which returned 5.6% and 4.9% respectively in January.

Many of our portfolio holdings bounced strongly in January after a weak December 2018 quarter, and we avoided most of the earnings downgrades across the small cap sector during the month, including Costa Group, Navigator Global, Wagners, Platinum Asset Management and Kathmandu Holdings Limited.

Company specific news flow (earnings updates aside) was relatively muted in January ahead of the February reporting season, with many market participants on holidays during the month and companies in "black-out" ahead of releasing their results. Reporting season has now kicked off and we are comfortable that our holdings will deliver solid results over the course of the month.

The Fund's technology stock holdings bounced back during the month after being sold off in the risk-off pull-back last quarter. **Afterpay Touchcorp (APT, +28.3%)** led the way following a strong operational update which confirmed an excellent Christmas trading period for the company, a material reduction in late fee income as a percentage of sales and net transaction losses at the lower end of their targeted range (0.6-1.0%). Importantly, the US business is gaining rapid traction with 650,000 new customers and 1,400+ retailers having transacted in the US since its launch in May 2018 and $260m of underlying sales having been processed through the US platform in H1 FY19. **Appen Limited (APX, +24.4%)** and **Altium Limited (ALU, +15.0%)** also rebounded strongly during the month. Both companies have a dominant market position in their respective industries and we expect they will release solid operating results and robust outlook statements when reporting later this month.

NRW Holdings (NWH; +19.2%) bounced back in January after being down 22.7% in the December quarter. We called out NRW's negative performance in our December quarterly newsletter but we remained steadfast in our conviction that the business was well placed going into the new year. Pleasingly, the market has seemingly now agreed with us. NRW's share price recovery was boosted by the contract award of Koodaideri Mine Plant Bulk Earthworks by Rio Tinto. Although this contract is not, in itself, material to NRW's order book, (being $85m of work over 11 months), the award is seen as a signal that NRW is a preferred contractor to Rio for the broader Koodaideri Project. The Project is Rio's flagship iron ore development where it will spend A$3.5b bringing the most technologically advanced mine in Australia into production by 2021. Koodaideri will supply an incremental 43 million tonnes of iron ore into the seaborne market, underpinning Rio's Pilbara Blend. The Koodaideri contract award follows on from several recent positive announcements at the back end of 2018 that included material contract wins and extensions across the civil, mining and drill & blast divisions of NWH, the securing of bank funding to repay corporate notes and, not least, a material profit upgrade with H1 FY19 earnings.

Pacific Current Group (PAC, +4.8%) announced that it had invested US$34.3m in Carlisle Management Company (Carlisle), a Luxembourg based Life Settlement asset manager with US $1.4b of funds under management. PAC will receive securities entitling it to 16% of Carlisle's revenues and 40% of the proceeds in the event of an asset sale and the purchase price implies an attractive 8.7x multiple on management fees and 5.7x including PAC's share of performance fees. Carlisle invests in "in-force" life insurance policies sourced via a network of intermediaries from policy holders who no longer want or need their policies. It uses third parties to assess policy risk, buys attractively priced policies at a premium to what the policy issuer would pay the holder, continues to pay the policy premiums and then collects the policy benefits at maturity. The company's flagship Long-Term Growth Fund has delivered over 90 consecutive months of performance and averaged returns of ~20% p.a. over the past five years. The business provides PAC with a further income stream un-correlated to equity markets and replaces the lost earnings from the recently divested Aperio stake at an enhanced rate of return. PAC remains attractively priced, trading on an "ex-cash" PE multiple of just over 8x and a 6.0% fully franked yield and with a remaining cash balance of $40m for further investments.

GUD Limited (GUD, +0.0%) released its interim result on the second last day of January with the company delivering softer organic growth than forecast with earnings around 6% behind consensus expectations. GUD is predominantly a supplier of market leading branded aftermarket car parts to both trade and retail distributors. GUD also owns a smaller water pump business. We like the defensive earnings profile of GUD which should grow organically given annual price rises, growth in the "car parc" and new product releases. Organic growth is likely to be supplemented by acquisitions of small private aftermarket automotive parts suppliers. In their recent 1H19 result GUD delivered softer organic growth than expected due to 1) a lack of new product releases in the half, 2) a line of products which were deranged by a distributor and 3) timing issues with respect to a new exclusive arrangement with the same distributor. We back GUD to rectify the majority of these issues in the second half of the financial year with most, in our opinion, being transitory and we gained significant comfort from our meeting with management. Pleasingly, the stock has bounced following their roadshow.

Eclipx Group Ltd (ECX, -8.2%) was the key detractor during the month following an earnings update that was around 5% below our expectation. Despite a solid performance from the core commercial fleet and novated lease businesses, the Grays insolvency and industrial auctions business continues to underperform and the consumer business is experiencing softer retail market conditions which is impacting its profitability. Investors may recall that ECX has agreed to merge with listed competitor **McMillan Shakespeare (MMS, +10.4%)** pursuant to a Scheme Implementation Agreement, so it appears the market was spooked by the prospect of MMS either walking away from the merger or renegotiating the terms. Whilst disappointing, we remain confident that the deal will complete on a delayed timeline given that:
a) the core ECX business which generates most of the earnings (the commercial fleet and novated businesses) continues to trade solidly and remains the key asset which garnered MMS's interest;
b) the deterioration in ECX's earnings does not appear to be sufficient to trigger a "scheme-out clause";
c) other corporate interest, including from ASX listed SG Fleet (SGF, -7.1%), is likely to mean that MMS may be reluctant to walk away or give a competitor an opportunity to engage the ECX board by attempting to re-negotiate the merger terms, especially given that the earnings miss was not significant and relates largely to non-core areas of the business. We have retained our holding as we continue to see upside upon confirmation of the merger proceeding.

Outlook

As the market rounded out calendar year 2018, a mood of extreme caution had driven equity markets valuations to the point where some dire outcomes were being priced into stocks, including arguably a material global economic slow-down and a potential US recession in the back half of 2019. Whilst a number of key economic and geopolitical concerns remain unresolved including ongoing trade and geopolitical tension between the

US and China, Brexit negotiations still in limbo and the Chinese economic outlook continuing to deteriorate, market sentiment has turned more positive and equities have rallied in response.

Clearly, when the overwhelming majority of investors become extremely bearish it does not take a lot of positive news to spark a sharp rally in equity prices. Valuation aside, there seems to have been two key catalysts for the improved risk appetite in January:

- Firstly, in an abrupt turnaround, the US Federal Reserve signalled that it was done raising interest rates in the near term and would be 'patient' about any future decisions on reducing its bond holdings. This was a marked change from the tighter monetary policy of just one month earlier that had spooked the market. The return of the so called "Fed Put" has no doubt emboldened investor risk appetite and alleviated concerns that the Fed was hiking too quickly and would drive the US economy into recession.
- Secondly, renewed optimism around a Sino-US trade deal in the near future and a pause from the escalating hostilities between the two nations further calmed the nerves of investors during the month. Aside from optimistic rhetoric from both sides during the month, including talk of good spirit and intent on both sides, nothing has yet been formalised between the two countries. Late in the month President Trump hosted the Chinese Vice Premier Liu He and a high-ranking Chinese trade envoy at the White House to engage in wide ranging discussions around the economic relationship between the two countries. Whilst Chinese President Xi Jinping remains hopeful that the two countries can 'meet halfway', the March 1st deadline for tariff escalation is approaching and a failure of the two countries to reach a compromise would likely result steep market sell-off due to the negative implications of further trade tariff on global economic growth.

Heading into February reporting season we remain concerned that the Australian economy is softening and our policy makers have limited tools at their disposal to address any protracted economic downturn given that interest rates are already at historic low levels. The risks to the economy are mounting and include:

- falling house prices with the key Sydney and Melbourne markets showing no sign of bottoming and credit conditions tightening;
- building approvals slumping, down a further 8.4% in December taking the fall in new residential approvals to 22.5% for 2018;
- weak retail sales which deteriorated further over the Christmas trading period, especially discretionary items such as clothing, footwear and household goods;
- new car sales in the doldrums with new vehicle sales down a further 7.4% in January;
- business conditions deteriorating with the influential NAB survey indicating business conditions in Australia have recorded their steepest monthly fall since the GFC in December;
- the economy of our major trading partner, China, continues to deteriorate.

The RBA remains relatively upbeat about the prospects for our economy, although it has modestly downgraded its GDP forecasts for 2019 and 2020 to 3.0% and 2.75%, down from its prior forecast of 3.25% and 3.0%. Clearly the RBA remains heartened by the strong labour market (unemployment is forecast to be 4.75% over the next few years) and the benign level of inflation with the bank recently downgrading inflationary expectations to 2.25% by the end of 2020. Interest rates are clearly on hold for some time and RBA governor Philip Lowes' dovish shift to an "evenly balanced" stance on the direction of rates.

We are a little more circumspect about the domestic economy and the portfolio remains skewed towards either companies with either robust earnings growth which ought to generate a premium rating in a slowing growth environment, companies that can grow their earnings outside of the economic cycle or offshore earners.

We are approaching the earnings season with cautious optimism and are confident that we have a strong understanding of the fundamentals of the companies within our portfolio and a firm belief that the market will reward their earnings and cashflow generation over the long-term. Over the coming six weeks our four analysts will meet with around 200 ASX listed companies with a view to refining our portfolio so that we can continue to generate strong investment outcomes for our clients over the coming years.

Top 5 holdings#

Company	ASX code
Bapcor Limited	BAP
Mineral Resources Ltd	MIN
Nextdc Limited	NXT
Reliance Worldwide	RWC
Seven Group Holdings	SVW

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

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

John Clothier	General Manager, Distribution	0408 488 549 | jclothier@copiapartners.com.au
Iain Mason	Director, Institutional Business	0412 137 424 | imason@copiapartners.com.au
Mani Papakonstantinos	Distribution Manager	0439 207 869 | epapakonstantinos@copiapartners.com.au
Matthew Roberts	Distribution Manager	0438 297 616 | mroberts@copiapartners.com.au

†The total return performance figures quoted are historical, calculated using soft close, 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 index does not incur these costs. This information is provided for general comparative purposes. Soft close unit prices are interim unit prices struck at month end before all transactions for the month have been completed. Performance data available on the OC website, ocfunds.com.au, however, is based on hard close unit prices which are struck after all transactions for the month have been completed.

* 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.

Past performance is not a reliable indicator of future performance. Positive returns, which the OC Premium Small Companies Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. A performance fee of 20.5% is payable annually on any excess performance (after deducting the management fee) above the benchmark, S&P/ASX Small Ordinaries Accumulation Index, to 30 June. A performance fee is only payable where the Fund has returned 5% or more since the last performance fee was paid. 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 Premium Small Companies Fund (ARSN 098 644 976). 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.