FUNDS MANAGEMENT

OC Dynamic Equity Fund

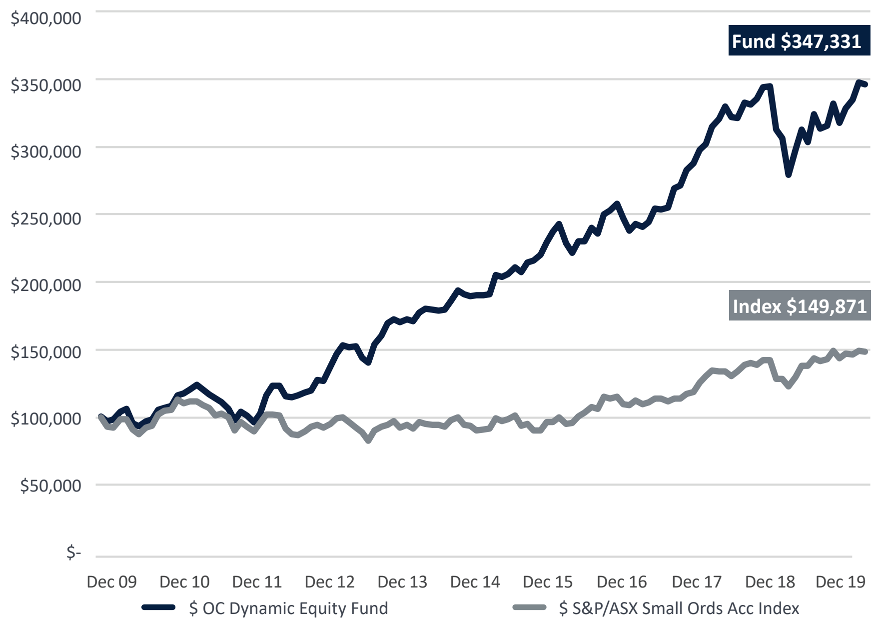
Fund Update | 31 December 2019

5.5% Fund up 5.5% for the quarter

24.0% Returned 24.0% for CY19

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 December 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 Dynamic	-0.3	5.5	24.0	12.6	12.8	14.2	13.3	12.6
S&P/ASX Small Ords Accum	-0.3	0.8	21.4	10.0	10.6	6.8	4.1	6.3
Outperformance	**0.0**	**4.7**	**2.7**	**2.6**	**2.1**	**7.5**	**9.2**	**6.3**
S&P/ASX Small Ind Accum	-1.4	0.9	24.5	10.4	10.5	10.4	8.2	6.9
Outperformance	**1.1**	**4.6**	**-0.5**	**2.2**	**2.3**	**3.8**	**5.1**	**5.7**

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.

Performance review

The OC Dynamic Equity Fund capped off the calendar year with a strong December quarter, finishing up +5.5%. This was comfortably ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which returned 0.8% and 0.9% respectively for the quarter.

Calendar year 2019 has been a strong period for both equities and bonds globally, with these asset classes each producing stellar returns. Markets have shaken off concerns about the highly emotive trade spat between China and the US, fears of a slowdown in global growth and a raft of geopolitical issues to post strong returns. Central banks, led by the US Federal Reserve which cut rates three times during the year, are largely to thank for the bullish sentiment, with monetary policy settings in most countries sitting near record low levels which, in turn, has been a key catalyst for higher asset valuations.

The Australian small-cap market was no exception with the S&P/ASX Small Ordinaries Accumulation Index up +21.4% for the calendar year. Pleasingly, the OC Dynamic Equity Fund finished ahead of the Index with a return of +24.0% for the year, which was a credible result given that we maintained a healthy cash buffer of around 10% over the calendar year as a hedge against any deterioration in the global economic landscape. With the benefit of hindsight, it would be easy to say we ought to have taken on more risk for investors during the year. However, long term investors will be aware that capital preservation for our clients is one of OC's key investment mantras and we felt this level of conservatism was warranted given the significant levels of uncertainty that persisted through much of the year, particularly around global trade relations and the overall health of the global economy.

Key successes for the Fund during the quarter included The **Citadel Group (CGL; +35.2%)** which rebounded strongly after a challenging year during which the company missed its FY19 earnings guidance after key customer spend fell significantly in the lead up to the Australian federal election (the Federal Government comprises a high portion of CGL's customer base) as the government went into 'care-taker' mode during the election campaign. Whilst we typically sell unexpected earnings downgrades, barring extenuating circumstances, in this instance we elected to retain our holding in CGL given that government spending had been put on hold in the critical end of financial year period which was largely beyond the company's control. A key catalyst for the re-rate during the quarter has been the return of founder, and major shareholder, Mark McConnell as Managing Director and the reiteration of FY20 earnings guidance which has refocussed the markets attention. CGL has recently made a strategic pivot away from managed services contracts, which typically include a large up-front licence fee, toward a Software-as-a-Service (SaaS) style recurring revenue model which has seen revenues and margins fall this year. Under a SaaS model, these earnings ought to become higher quality, stickier revenue streams going forward. Whilst the CGL share price has rebounded strongly, we still see material upside should operational execution be sound in the coming 12 months.

The Fund added **Sealink Travel Group (SLK; +34.9%)** to the portfolio in October following its acquisition of Transit Systems, a major operator of metropolitan bus services to governments in Australia, the UK and Singapore and the stock was a stellar performer during the quarter. The combination of the SLK with Transit Systems leads to the creation of a leading Australian integrated land and marine passenger transport business, with enhanced scale and capabilities to compete for large government contracts. We considered the deal to be transformational and significantly value accretive for shareholders and we participated in the capital raising to fund the transaction and, in addition, we purchased stock on-market during the quarter. Transit Systems diversifies SLK's operations into a more capital light business model with defensive earnings which are largely underpinned by sticky long-term government contracts. The key management personnel from Transit Systems have opted to take most of their transaction consideration as SLK scrip, signalling their confidence in the future of the combined business. The group has multiple organic growth avenues, including further opportunities in government bus contracts in both Perth and Sydney, as well as potential opportunities in ferry markets in Singapore and London.

Portfolio stalwart **Fisher & Paykel Healthcare (FPH; +31.5%)** delivered another high-quality result with its interim FY20 numbers exceeding market expectations. FPH is a leading respiratory equipment manufacturer supplying to hospitals and homecare providers globally. The company is the global leader in the hospital humidification market with equipment in most of the world's hospitals. It was Hospital division which again provided the highlight, underpinned by solid hardware growth (+18% in constant currency) and New App Consumables (+23% in constant currency). The performance of the smaller Homecare division was soft, as expected, with constant currency revenue declining 1% in the half. We expect the division to return to growth following the release of the new Vitera OSA mask, which has had encouraging results following its release into the US market in October. FPH is a high-quality business which has consistently grown its revenue, profits and earnings per share for many years irrespective of underlying economic conditions in its various markets and it remains a core holding for the Fund.

During early December, we undertook a site visit to the Hammersley Range in the Pilbara region of Western Australia to better understand the role that long-term Fund holding, **NRW (NWH; +39.2%)** is playing in the development of Rio Tinto's (RIO) major new flagship project, the US$2.6b Koodaideri iron ore mine. The mine will commence production in 2021 and when fully ramped up will produce 43 million tonnes of iron ore per annum over the following 20 years (and it also includes scope for stage 2 expansion of a further 30 million tonnes per annum). To date, NWH has been appointed contractor for bulk earthworks, mining pre-strip and rail infrastructure with a total contract value of approximately A$300m. Following our site visit, we now have an enhanced understanding of the sheer scale of the new mine, NWH's scope of works, and importantly its ability to win further add on contracts near term, through the benefit of site incumbency, and also its positioning to be appointed as contractor should RIO go ahead with the stage 2 expansion of the project (a decision we expect inside the next 12 months). During our time in the West, NWH completed its previously announced $310m acquisition of BGC Contracting which firmly cements the combined group as WA's preeminent mining and civil construction contractor. We see 2020 as another year of growth for NRW and continue to back the management team to deliver on shareholder expectations.

Evolve Education (EVO; +84.2%) was a strong performer for the Fund during the quarter as the first signs of an expected corporate turnaround in this previously struggling childcare operator began to emerge. On 19 September 2019, a new board took charge of EVO with operational control passing to Australian childcare industry veteran, Chris Scott, and his deputy Chris Sacre (previously COO at G8 Education). We are well acquainted with Chris Scott and he has been a proven 'money maker' for OC Funds in the past at management letting rights business, S8 Limited, in the 2000's and at current listed childcare business, G8 Education, which he built into a market leader before leaving the group in 2017. Under the new management team, EVO has embarked on an aggressive turnaround strategy that ought to have a meaningful impact on its financial performance moving forward. The key components of these changes include materially cutting head office costs (annualised savings of $3.4m with effect from December 2019), board fees have been reduced, strict controls on price discounting have been introduced and prices increases implemented across the business.

In the past few months, the new team has acquired 15 operating childcare centres across Australia, which appear to have been purchased on reasonable earnings multiples, that should contribute materially to overall group earnings immediately. In December, we invested alongside the key management in a placement to fund the further growth of the business. We continue to back the new management team to stabilise and turnaround the kiwi operations, whilst growing the Australian business, and see strong potential for the share to re-rate with solid execution on the new strategy.

Panel beating aggregator, **AMA Group (AMA; -25.6%)**, had a busy quarter announcing the acquisition of Capital SMART Repairs from Suncorp Insurance Ventures (Suncorp) in early October (see October Monthly Review) but then releasing a disappointing earnings update in late December. Management have guided to a normalised FY20 EBITDA of $73-77m, which was 13% below consensus analyst estimates at the mid-point of the range. The softer trading conditions have been attributed to prolonged drier weather conditions, which have impacted volumes in the panel division, and softer new car sales having a negative impact on the ACAD division, which also incorporates the automotive consumables and parts and procurement components function of the panel repair business. On a more positive note, management confirmed that the integration of Capital Smart and ACM Parts businesses was proceeding better than expected and confirmed both the synergy target ($17m) and the FY21 earnings contribution were expected to be “at least” in line with those disclosed at the time of the acquisition. Whilst the earnings downgrade was disappointing, we continue to believe that AMA is now in a formidable position to continue to grow its market share, through both greenfield site roll-outs and through further acquisitions, once the Capital SMART acquisition is bedded down. The Australian panel market remains several years behind both the US and UK markets where large aggregators have taken dominant market positions as insurers gravitate towards large, well run operators in order to improve efficiencies and lower their overall repair costs. We see this structural change beginning to play out in Australia and AMA is well positioned to capitalise on this industry dynamic.

Following on from the tragic incident in Burkina Faso in November, **Perenti (PRN; -27.3%)** was forced to update the market in December with downgraded earnings guidance. Whilst the November incident at the Boungou mine (where 19 PRN staff were killed by terrorists), and the subsequent withdrawal by PRN from that operation, was not in itself a material impact on PRN earnings, subsequent events elsewhere in the African Mining Services (AMS) division have caused management to reforecast FY20 earnings from an anticipated A$140m, down to approximately A$115-120m (-17.6%). These developments included the decision by PRN to withdraw its services from the Bissa mine, also in Burkina Faso, for safety reasons and the termination of the Nsuta manganese mine equipment hire contract by the Ghana Manganese Company (GMC). We believe this contract termination was the result of a dispute between GMC and the Ghanaian government, and out of the control of PRN which had been performing well at the mine. Nevertheless, the financial impact of this termination was particularly impactful on PRN’s FY20 earnings forecast. As we wrote in our November monthly, PRN is otherwise committed to its African operations, where it has successfully carried on business for several decades. Whilst Africa will never be “smooth sailing” for PRN, we do see the benefits of having a presence in this important mining jurisdiction, including through the very profitable African Underground Mining Services (AUMS) division which delivers double the margins of the AMS division. We continue to support the PRN management team and the PRN business and believe it’s a highly competent contract miner that appears good value at these lower levels.

Outlook

As we enter calendar year 2020, there remains plenty to be optimistic about with the global economy tracking solidly, the US and China have announced an agreement on a “phase one” trade deal and global interest rates remain near record lows and looking likely to stay that way for some time. The domestic economy has slowed over the second half of the year but there is some cause for optimism from an economic perspective entering the new year, although the awful bush-fires have put a major dampener on the Christmas and new year celebrations and our hearts go out to all of those impacted by this terrible disaster.

The Sino-US trade dispute received a significant amount of air time in 2019 and there has been a raft of ‘false starts’ in reaching agreement on key issues so it is pleasing to see some progress being made with the announcement of the first phase of the deal in mid-December. Whilst the full terms of the agreement are yet to be revealed, it seems that the US has agreed to rescind some existing tariffs and delay the imposition of new ones in order to lower trade tensions (which could materially hurt the economies of both countries). In return, China has agreed to buy US$40-$50b of US farm products and made fresh commitments to improve intellectual property protections. The deal is expected to be inked in Washington on January 15 and Trump has said that he will travel to China “at a later date” to begin second round talks. Whilst the agreement falls well short of resolving the more contentious issues between the two countries, including forced technology transfers and intellectual property protection, the de-escalation of tensions comes as a welcome relief and gives some cause for hope that a broader, more permanent deal is possible, notwithstanding the fundamental ideological differences between the two global superpowers.

In the US, which remains the most influential driver of the global business cycle, the economy is strong heading into 2020, with robust economic growth, the unemployment rate holding a near 50-year low and inflation seemingly in-check. We have entered an election year in the US and despite the ongoing controversy over impeachment of the incumbent President this is likely to be a sideshow with the broader election, scheduled for November 2020, to take centre stage. Trump is generally seen as "market friendly" and any indications that he may not be returned to office could trigger a market sell-off. The actions of the US Federal Reserve (the Fed) will once again be critical to equity market performance. Rates look to be on hold in the US over the medium term which ought to be supportive of equity markets. Depending on the path of inflation and employment, investors could begin to price in Fed rate hikes from 2021. We view the Fed's monetary policy decision making as the most important policy variable that we will be monitoring in 2020.

The Chinese economy, another major driver of global growth, continues to face headwinds entering 2020. The People's Bank of China has recently announced that it would again cut its reserve requirements, freeing up about US$115b to boost lending and spur economic growth. The move follows similar action in September and suggests that the central government remains concerned about faltering growth, despite signs that the world's second largest economy is stabilising. China's leaders are contending with the slowest pace of growth for almost three decades and the country's slowdown has rippled through the global economy, including Germany which has narrowly avoided recession as its manufacturing sector has slumped, in part due to reduced demand out of China. China's struggles have impacted much of Asia where it is the dominant economy, as well as Africa, Latin America and other parts of Europe which have seen their manufacturing sectors contract. China remains Australia's largest trading partner by a considerable margin so we will be monitoring its economic progress carefully in the new year, particularly its appetite for natural resources which has a large overall impact on the Australian economy.

Little has changed in domestic economy over the quarter and the Reserve Bank of Australia (RBA) kept rates on hold at 0.75% following 25 basis points cuts at each of the June, July and October meetings. On a domestic front, the national accounts released early in December indicate that the Australian economy continues to grow below the long-term average, expanding by an underwhelming +0.4% in the September quarter, with annual growth rate of +1.7% marginally above the +1.6% recorded in the June quarter. Whilst this could technically satisfy the RBA's assessment that the economy has passed a 'gentle turning point', we remain cautious on the economy's trajectory into 2020 and expect at least one further interest rate cut in 2020.

Anecdotally, our straw poll of retailers and service providers suggests that it was a solid, but not spectacular, Christmas trading period. We remain underweight domestic cyclical exposure heading into the new year, although we expect that there will continue to be companies that perform strongly with Kogan.com Ltd and Baby Bunting Group Ltd among our preferred exposures. Renewed strength in the property market is a genuine cause for optimism with house values surging +4% in the December quarter according to leading property analytics group, CoreLogic. The residential market has been bolstered by lower interest rates and an easing of credit conditions and we expect property prices to rise further into the new year, with some bullish commenters forecasting double digit returns in the key Sydney and Melbourne markets. The sentiment impact of rising property prices is likely to provide a boost to consumer spending in 2020 via the so called 'wealth effect' whereby consumers typically feel more comfortable spending money in an environment of rising house prices. We will be monitoring this carefully into 2020 and will look to add to our retail exposure should the consumer environment improve.

In recent days, tensions between the United States and Iran have soared following the assassination of Qassem Soleimani, who headed the foreign arm of the Islamic Revolutionary Guard, Iran's elite military force. Soleimani was deeply popular domestically and also amongst Tehran's allies and both Iranian President, Hassan Rouhani, and the supreme leader, Ayatollah Ali Khamenei, have vowed to exact swift and severe revenge. The killing, by drone strike, was sanctioned directly by US President Trump, with the US Department of Defence claiming Soleimani was developing plans to attack American diplomats and military personnel throughout the Middle East region.

Global markets have gone into 'risk-off' mode following the airstrike and equity markets have retreated, the oil price has spiked above US$70 per barrel and the gold price has hit a six-year high. It is difficult to predict the long-term effects of this move by the US. Whilst a retaliatory response can be expected from Iran, the country is struggling economically. Iran has said it would no longer abide by any limits of an international nuclear deal agreed in 2015, which aimed at preventing Tehran from building atomic weapons. President Trump has issued a threat to hit 52 Iranian sites "very hard" if Iran attacks American or US assets in retaliation for the attack. Should hostilities between the two countries escalate - clearly a distinct possibility - a sharp market correction can be expected. We will monitor developments carefully in the coming days and weeks and stand ready to make any changes necessary to the portfolio.

We have now entered the 'black-out' period between the end of December and the February reporting season. Most corporates are enjoying their summer vacations and those broking firms that are open are operating on skeleton staff. As such, limited stock-specific news is typically released in the month of January. January is likely to provide some welcome respite from company meetings for the investment team after a very busy end to 2019, albeit we continue to work diligently throughout the month preparing for the year ahead and making any portfolio changes that may be necessary to deal with the changing geopolitical climate or as a result of the terrible bushfires.

We would like to thank our investors for their ongoing support throughout 2019 and wish you all the best for a safe and prosperous new year. We enter the 2020 confident our stocks are performing well operationally and that we can continue to deliver attractive long-term returns for our investors.

Top 5 holdings#

Company	ASX code
Appen Limited	APX
Bingo Industries Ltd	BIN
NextDC Limited	NXT
Seven Group Holdings	SVW
Webjet Limited	WEB

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
Jude Fernandez	Distribution Manager	0414 604 772 | jfernandez@copiapartners.com.au
Sam Harris	Distribution Manager	0429 982 159 | sharris@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 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.

Past performance is not a reliable indicator of future performance. 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.