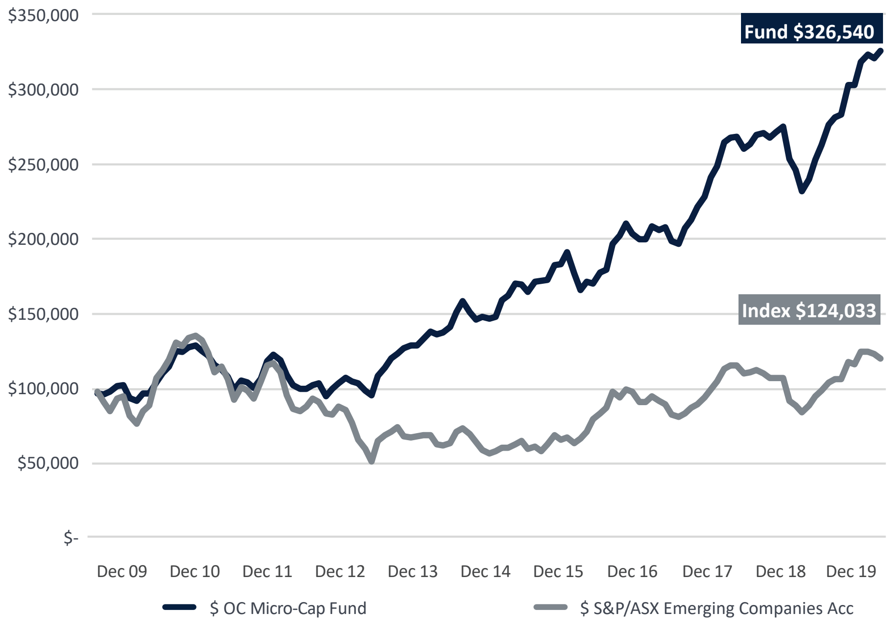
OC Micro-Cap Fund
Fund Update | 31 December 2019

2.3% Fund up 2.3% for the quarter

41.2% Returned 41.2% for CY19

We remain confident the Fund is well placed to deliver strong 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. (Mar 2003)
OC Micro-Cap	1.7	2.3	41.2	18.1	17.7	19.0	13.3	14.1
S&P/ASX Emerging Comp. Accum	-2.0	-3.3	30.9	7.2	11.5	4.1	1.6	NA
Outperformance	**3.7**	**5.6**	**10.3**	**10.9**	**6.3**	**14.9**	**11.7**	**NA**

Inception date for the Fund is 21/11/2003. Inception date for the Index is 31/12/2003. The performance reflects the performance of the OC Micro-Cap Fund since the change of strategy on 30 September 2016 and the performance of the OC Concentrated Equity Fund prior to that date. Performance is after fees applicable at the time. 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 Micro-Cap Fund capped off the calendar year with a solid December quarter, finishing up 2.3%. This was well ahead of the S&P/ASX Emerging Companies Accumulation Index which was sold off 3.3% during 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 micro-cap market was no exception with the S&P/ASX Emerging Companies Accumulation Index up +30.9% for the calendar year. The OC Micro-Cap Fund fared better posting a return of +41.2%. We are particularly pleased with this 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.

We are also particularly pleased that the key drivers of the strong performance of the Fund during the calendar year were generally profitable cash-flow positive stocks, with companies such as Viva Leisure Limited (VVA, +175.0%), NRW Holdings (NWH, +100.0%) and McPherson's Limited (MCP, +98.4%) amongst the key contributors. The robust performance of the micro-cap index itself has been significantly enhanced during the year by biotechnology stocks, including Opthea Limited (OPT, +413.8%), Polynovo (PNV, +231.1%) and Paradigm Biopharmaceuticals (PAR, +185.7%), early stage gold companies such as Red 5 Limited (RED, +270.8%) and Alacer Gold Corporation (AQG, +190.0%) and higher risk businesses like iSignthis Ltd (ISX, +590.3% but currently suspended from trade by the ASX) and Phoslock Environmental Technologies (PET, +127.9%). The Fund rarely invests at the more speculative end of the micro-cap market where things can quickly go amiss and, as a result, we may pass up the opportunity for these spectacular returns. However, we firmly believe that our disciplined investment approach and focus on the quality end of the market will lead to fewer stock blow-ups, lower overall volatility and more consistent returns for investors over the long-term.

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. NWH has served the Micro-cap portfolio well over a number of years, growing both organically and by acquisition, but now, with a market capitalisation above $1bn (from our entry around $100m), we will be looking to exit the position.

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.

One the Fund's longer-term holdings, **National Veterinary Care (NVL; +48.4%)**, received a takeover bid in mid-December which was a nice early Christmas present for our investors. We have been long term supporters of NVL since its IPO in August 2015 as a $50m market capitalisation, ASX minnow. The agreed $3.70 per share bid (a 56.8% premium to the last price) from VetPartners, through a scheme of arrangement, values the equity of the business at just under $250m and will bring to a conclusion our almost five-year association with NVL and its outstanding Managing Director, Tomas Steenackers.

Another of the Fund's holdings, **CML Group (CGR; +17.9%)**, received an underwhelming "merger of equals" proposal from one of its peers, Consolidated Operations Group (COG), during the quarter. Whilst we could see the merit in the proposed tie up, we also thought CGR was worth more than what the proposal valued the business at and, fortunately for our investors, this view was vindicated shortly before Christmas when Scottish Pacific came over the top with a competing all cash bid, valuing the business at a significant premium to the COG deal. Whilst the Scottish Pacific deal remains non-binding and conditional, the CGR board has recognised it as a superior proposal and is engaging with Scottish Pacific to enable it to progress its proposal. Since the initial COG merger deal was announced, we have added to our position in CGR and continue to hold our stake with a view that the Scottish Pacific proposal will be affirmed in the near term, post the completion of limited due diligence.

During December, Adelaide based aerial mapping business, **Aerometrex (AMX; +97.0% since IPO)**, listed on the ASX. This was a particularly satisfying outcome for the investment team as AMX was a stock identified as a potential Micro-cap holding at the pre-IPO investment stage in mid-2019. The fact that AMX has since hit all its financial targets and subsequently listed in line with timeframe expectations, and at a nice premium, is a clear demonstration of the benefits of pre-IPO investing. AMX is not a large Fund holding at this point (at around 1% of our total portfolio), the company has a strong technology suite and we look forward to the ongoing growth of the business.

During the quarter, the Fund also invested in other successful IPOs including **Carbon Revolution (CBR; +50.4%)**, **Nuchev (NUC;+38.4%)** and **Amaero International (3DA; +72.5%)**. Each of these new names are concept model investments in that they are not yet profitable, albeit they have a pathway to profitability within 3-5 years. Whilst it is unlikely that all three will turn into longer term holdings for the Fund, it is undoubtedly to the benefit of our investors to be able to access opportunities such as these.

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, likely 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 Adairs Limited and Mosaic Brands 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
Propel Funeral	PFP
QMS Media	QMS
RPMGlobal Holdings Ltd	RUL
Viva Leisure Limited	VVA
Zenith Energy Ltd	ZEN

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 hard-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 Emerging Companies 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.