FUNDS MANAGEMENT

OC Premium Small Companies Fund

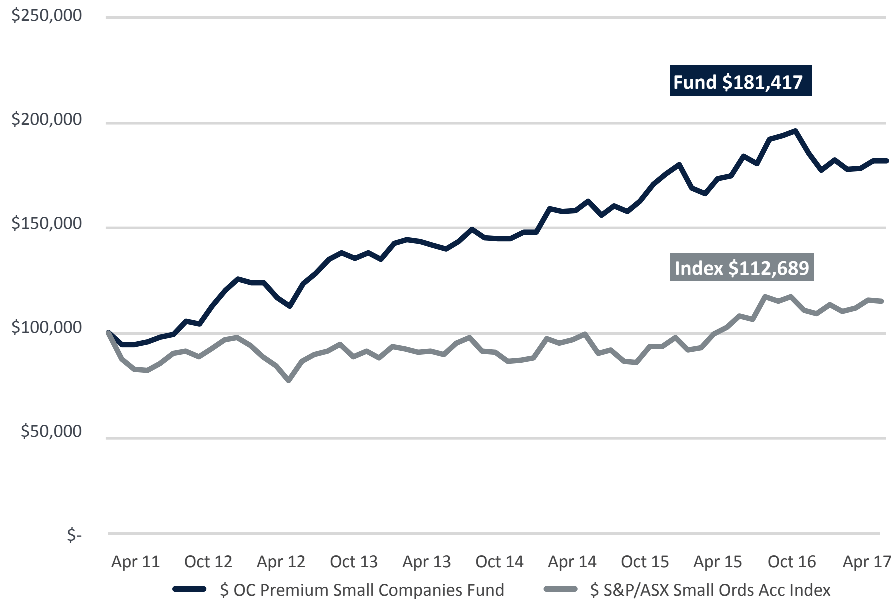
Fund Update | 30 April 2017

12.7% Returned 12.7% p.a. for the past five years

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

We welcome Daniel Stein to the investment team

Performance comparison of $100,000 over 5 years*



Total returns

At 30 April 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 Premium	0.0	2.2	3.9	8.3	12.7	11.4	3.4	10.9
S&P/ASX Small Ords Accum	-0.2	3.7	10.0	6.8	2.4	2.1	-1.3	5.4
Outperformance	**0.3**	**-1.5**	**-6.1**	**1.5**	**10.3**	**9.3**	**4.8**	**5.5**
S&P/ASX Small Ind Accum	0.6	6.6	9.6	8.7	9.6	7.9	1.1	6.1
Outperformance	**-0.5**	**-4.4**	**-5.6**	**-0.4**	**3.2**	**3.5**	**2.4**	**4.8**

Performance review

The OC Premium Small Companies Fund finished the month of April flat which was ahead of the S&P/ASX Small Ordinaries Accumulation Index (-0.2%) but behind the S&P/ASX Small Industrials Accumulation Index (+0.6%). The Fund maintains a strong long-term track record having returned 12.7% 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 2.4% p.a. and 9.6% p.a., respectively, over the same time horizon.

a2 Milk Company (A2M, +13.1%) – had another strong month in April as the company continues to evolve from a branded Australian and New Zealand liquid milk company to become a global nutrition firm. The company announced a positive trading update at the end of the month, highlighting demand for its a2 Platinum Infant Formula product had exceeded expectations in Australia (and through cross-border e-commerce into China). A2M now has a ~33% market share in Australia (based on last quarterly data) which highlights the strength of the brand. Additionally, the brand is growing rapidly in China with recent Kantar data indicating ~3% market share in China with the company targeting 5% share in the medium term. A2M is working with its supplier, Synlait Milk (SM1 +1.6%), to increase production above current levels given recent supply constraints, auguring well for future growth. The UK business is now profitable and the company is investing heavily in building its presence in the fresh milk market in the US with some pleasing progress demonstrated at the recent interim result.

Listed investment managers, **BT Investment Management (BTT, +19.4%)** and **Pacific Current Group (PAC, +15.6%)**, each provided positive updates to the market during the month and moved higher accordingly. Funds management businesses are highly leveraged to FUM flows and when managers are winning money, performance is solid and the markets they are investing in are moving in their favour, the earnings uptick can be considerable. BTT announced mid-month that its quarterly FUM had grown by net A$4.2billion (or around +4.8%). As if to illustrate the leverage inherent in its business, BTT pointed out the FUM won in the last quarter would lead to approximately $10m incremental annual revenue (at what will be next to zero incremental cost). Despite an extended period of underperformance, PAC may finally be getting its act together with its long overdue corporate restructure (simplification) being implemented during April. PAC followed this up with a bullish update on quarterly FUM flow later in the month. PAC stated its total FUM was at A$57.5 billion, an +11.2% improvement on the December quarter, and this was primarily driven by strong net FUM inflows with a further tailwind from positive fund performance.

Ardent Leisure (AAD, +10.9%) – performed well during the month on the back of speculated corporate activity and the announcement of a management team restructure. In late March, ASX-listed investor, Ariadne, revealed it had a 5% stake in Ardent, which it has built up to 8% as of its latest filing. Some are speculating this move by Ariadne could precipitate a corporate play for AAD or even a break-up and the stock has traded higher as a result. Then in late April, the AAD board announced changes to the management team with current CEO, Deborah Thomas, who had been in the role for just two years, moving on to be the Chief Operating Officer (Australasia) and Chief Customer Officer for the group. Thomas will now be prioritising the ongoing transformation of the theme parks business, group marketing, media and corporate affairs. She will be replaced by Simon Kelly who was previously COO/CFO of Nine Entertainment. The AAD CFO also resigned for personal reasons (returning to the UK) and a search is underway for a replacement. While we don't have a strong view about this particular management restructure, we note they can be disruptive, particularly in terms of strategy. We also note anecdotal evidence the key Main Event business in the US, already under pressure in terms of like-for-like growth numbers, is facing increasing competition particularly in the key state of Texas. We have used the recent share price rally to exit our holding in AAD. We are not convinced Ariadne has the will or ability to privatise AAD and the share price is near our revised valuation for the company.

Baby Bunting (BBN, -11.4%) and **Super Retail Group (SUL, -7.8%)** - both seem to be falling victim to the Amazon effect which is spooking many investors in traditional retail businesses. Talk about Amazon's impending entry into Australia has been considerable over the past month. Whilst Amazon's entry will undoubtedly have some impact on many traditional retail incumbents (including BBN and SUL) we believe these businesses, in particular, have qualities that position them well to withstand the 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 competitors out of business due to its compelling prices and range. 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 and the share price reaction of these two market leaders has been overdone.

Bapcor (BAP, -10.3%) – rolled off during the month as investors began to digest the potential impact of Amazon on traditional Australian retailers. We think Amazon's impact on BAP will be limited due to BAP's deep customer relationships and service offering. BAP typically does not compete aggressively on price, which is one of Amazon's primary competitive advantages, but rather on more qualitative grounds such as service levels and a timely delivery of product. More specifically, BAP's trade business, which delivers around 60% of group earnings, is very much aimed at professional mechanics and workshops. BAP operates +150 stores across Australia and NZ servicing mechanics and related trades daily on a time-critical basis - a specialty service we don't expect Amazon to materially impact upon over any time horizon. Furthermore, the specialist wholesale business (15% of group earnings) is the number one or two specialist in various parts programs including brake, engine, bearings, suspension and gaskets. BAP's customers in this division are relatively price agnostic preferring to have a relationship with a reliable supplier of these specialist parts. For these reasons, we see the Amazon "threat" as limited for BAP. We have used this period of weakness to top up our holding in BAP, which we believe remains well positioned to outperform longer term.

Outlook

In his May Statement on Monetary Policy, Reserve Bank Governor, Philip Lowe, provided a relatively upbeat assessment of the growth prospects of the Australian economy following a stronger-than-expected rebound in the domestic economy in recent months. The transition period following the end of the mining boom, discussed many times in our monthly updates since the GFC, appears to finally be in the rearview mirror. Furthermore, signs are emerging that the slowdowns in the Queensland and Western Australian economies are coming to an end.

Although key economic indicators remain mixed (the unemployment rate has moved a little higher over recent months, wages growth remains slow, inflation has ticked up above 2% in the March quarter), the domestic economic outlook continues to be supported by low interest rates which are expected to remain on hold in the short to medium term. In a bullish assessment of our economic prospects, the RBA is forecasting growth to accelerate gradually over the next couple of years to a little above 3%, the strongest growth outlook since before the GFC.

At the coal face of corporate Australia, the mood appears to be somewhat guarded with the consensus of companies we have seen in recent weeks suggesting the economy remains delicately poised. Few company executives are prepared to talk up the prospects of an improved operating environment just yet, although equally few (retailers aside) are pointing to an underlying deterioration in operating conditions.

The recent Macquarie Conference in early May allowed us to meet with over 40 Australian small-cap companies in less than three days, in addition to the extensive company contact we have had during our interstate and international road trips over the last month. On the negative side of the ledger, common themes to have emerged in discussions include softness in retail conditions experienced by some (not all)s in recent months, caution about an overheated property market in Sydney and Melbourne and political uncertainty and currency weakness (predominantly the British pound), impacting offshore operations. On a positive note, companies have called out ongoing strength in domestic tourism providing an economic boost, an improved outlook for infrastructure spending (bolstered further by the recent federal budget) and a stronger global growth outlook was highlighted by several offshore-exposed corporates.

Political events in Europe have been front of mind with British Prime Minister Theresa May calling an early election and the French heading to the polls during April/May. The British pound surged after May unveiled plans for an 8 June election, some three years early, as she seeks to strengthen her government's mandate ahead of negotiations over Britain's exit from the EU. Current polling indicates her Conservative party would likely extend its working majority in the House of Commons which may reduce the risk of negotiations breaking down and a chaotic 'Brexit'. In France, Emmanuel Marcon's decisive victory over anti-euro campaigner, Marine Le Pen, will strengthen the EU and deal a blow to the populist wave that has unsettled markets over the past year. Both these developments have been positive for equity markets, particularly European shares, and fund holding, BT Investment Management, has rallied strongly in recent weeks as a result.

The May federal budget was relatively benign with little to move the needle in either direction for most of our key portfolio stocks. Portfolio holding, RCR Tomlinson (RCR), ought to be a material beneficiary from the $75b 10-year infrastructure package unveiled to build roads, railways and airports across the country. Infrastructure spending could go some way toward offsetting any potential economic impact from a moderation in the housing cycle. Diagnostic imaging company, Integral Diagnostics, is also likely to be a beneficiary of more positive government sentiment towards the sector, including a move toward partial indexation and the elimination of proposed bulk-bill incentive reductions.

The major banks (which apparently includes Macquarie Group) were obvious losers in the budget after being hit with a new levy on liabilities, including customer deposits above $250,000, corporate bonds, commercial paper, certificates of deposit and Tier 2 capital instruments. This new tax is forecast to raise $6.2b between now and 2021. Furthermore, there will be a 0.5% increase to the Medicare Levy which will have an impact on most taxpayers and may well have some moderate impact on consumer spending.

We are pleased to announce a new addition to the OC investment team with Daniel Stein starting in early May. Dan is an experienced analyst with a passion for small-cap investing and experience on both the buy side (four years with Altair Asset Management in Sydney) and in corporate finance (Wilsons and Azure). Dan is a CFA charterholder who has strong knowledge of our investment universe and is an excellent cultural fit with our investment team. We would like to welcome Dan and look forward to him helping us to generate strong investment outcomes for our clients in the coming years.

Top 5 holdings#

Company	ASX code
Bapcor Limited	BAP
Blue Sky Alternative Investments Limited	BLA
Mineral Resources Limited	MIN
Speedcast International 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