CI BRUNSWICK FUND
QUARTERLY COMMENTARY REPORT

Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

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DECEMBER 2015

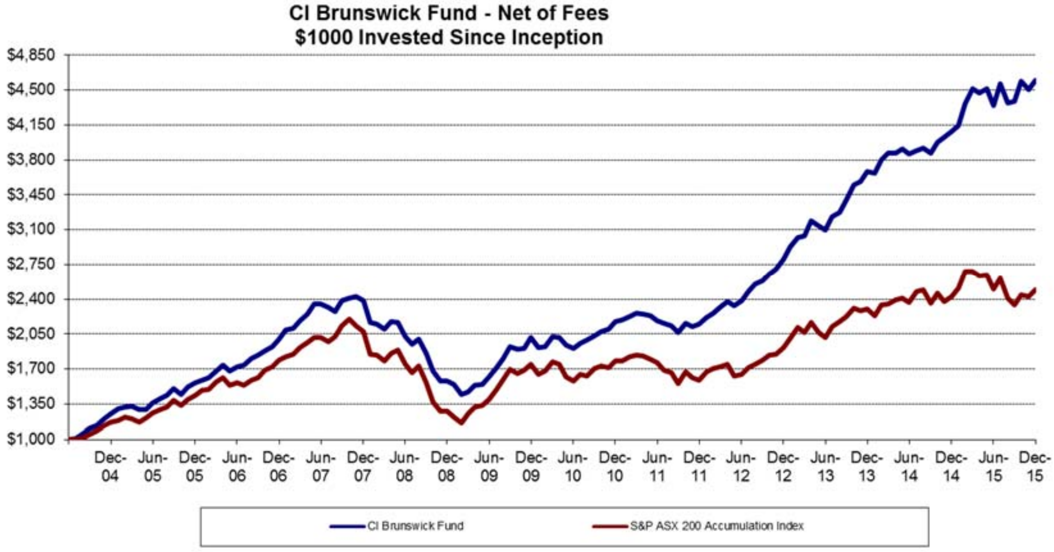
"Knowledge is knowing a tomato is a fruit; wisdom is not putting it in a fruit salad" Miles Kington

"It is the basics. It is focusing on selection, low prices and reliable, convenient, fast delivery. It's the cumulative effect of having this approach for 14 years. I always tell people, if we have a good quarter, it's because of the work we did three, four and five years ago. It's not because we did a good job this quarter." Jeff Bezos

"There are only two or three human stories, and they go on repeating themselves as fiercely as if they had never happened before." Willa Cather

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	5.12%	6.48%	-1.36%
ROLLING 1 YEAR	14.91%	2.56%	12.35%
ROLLING 3 YEAR	20.24%	9.20%	11.04%
ROLLING 5 YEAR	18.40%	6.97%	11.43%
ROLLING 7 YEAR	18.52%	10.01%	8.51%
ROLLING 10 YEAR	13.95%	5.64%	8.31%
SINCE INCEPTION*	17.66%	8.25%	9.41%
SINCE INCEPTION^	549.06%	148.99%	400.07%

* Annualised
^ Cumulative (1 July 2004)
** Before fees and expenses
# S&P ASX 200 Accumulation Index



Market and Portfolio Performance

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The market has staged a minor rally over the last quarter to be up by 6.48%. Coming after two consecutive quarters of negative returns, the stronger finish to the year was just enough to lift the total return index for the calendar year into positive territory at 2.56%.

The December quarter was characterised by numerous IPOs. In addition to continued strength in those companies linked to demand from China for high quality health and nutrition products, a notable take out was the severity with which the market treated any disappointing corporate news. For example, negative updates from companies such as Dick Smith, Slater & Gordon, Spotless, Bradken, MMA Offshore and Cardno was met with respective share price falls in excess of 50%.

It was another tough year for the resources sector in general, and it is the fifth consecutive year that both BHP and RIO have underperformed the broader market. BHP has given up all out-performance relative to the ASX 200 resulting from the largest mining boom ever experienced by Australia's mining sector. Management and directors have displayed little commercial acumen in positioning the company for the current and inevitable downturn. Further, now that that the veil of high oil/gas prices has receded it would appear the emperors of oil are also without clothes e.g. Origin and Santos.

The commodity price cycle is now moving into a new phase with prices at or below 50th percentile industry cash costs for many commodities (although we continue to be surprised by the fall in costs which is deferring the exit of some high cost producers). Supply continues to adjust with production closures and curtailments, consolidation of smaller players, emergence of opportunistic buyers (e.g. private equity), contraction in contractor order books and now more capital focused management behaviour.

While ten year bond yields have generally remained static or risen slightly over the quarter, a large number of government bonds in Europe remain negative. Foremost is Switzerland where rates are negative all the way along the curve to ten years, negative rates are seen out to four-five years in Germany, Netherlands, France, Denmark and Ireland amongst others. In addition the ECB deposit rate is now -0.3% i.e. it charges banks this amount to hold their deposits! This is a situation the world has not seen for a very long time. Given that most valuations are driven off interest rates/bond yields, there is now an opaqueness in one's ability to effectively value other securities.

Positive contributors to portfolio performance over the quarter included Australian Pharmaceutical Industries (strong earnings result), CSL (strong R&D pipeline of growth opportunities), Ryman (continues to build success in the Australian retirement market), and Bendigo (sector recovering after large capital raisings).

Contributors to underperformance included Sims Metal (scrap volumes have deteriorated further), Aurizon (asset write-offs and lower coal volumes), Recall (regulatory and shareholder concerns around the likelihood of the merger with Iron Mountain proceeding), Equity Trustees (earnings downgrade) and Jardine Strategic (Asian market exposure). The portfolio's cash position (circa 12%) and large underweighting of Australia's large retail banks also contributed to the portfolio's underperformance.

The Portfolio

The portfolio remains positioned around five pillars or stock clusters:

- **Stalwarts** (19% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (Brambles and Telstra)
- **Bond like equities** (13%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. (ALE Property Group, Auckland Airport, Carindale Property)

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- **Niche growth companies** (31%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Vitasoy, Summerset and Ryman)
- **Asset plays** (12%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Event Hospitality and Entertainment and Remgro)
- **Turnarounds** (11%) – sound businesses with good management in place and good balance sheets essential. We especially like government to private turnarounds. (Sims Metal)

Currently the portfolio holds around 12% cash. The portfolio has around 11% of assets invested in overseas markets with positions spread across USA, UK, Singapore, Mexico and Hong Kong listed companies.

Portfolio attributes as at December 2015 are summarized below:

P/E	17.5
Beta	0.72
Yield	3.5
P/Book	2.0
ROE	11.2
Tracking error vs. ASX 200	5.22
Stock Number	37

Major sector exposures are:

Sector	Portfolio Weight (%)
Healthcare & retirement	18
Industrials	13
Telecommunication	6
Non-Bank Financials	15
Foreign Equities*	7
Energy	8
Banks	7
Materials	5
Consumer	9
Utilities	0
Cash	12

** Excludes NZ stocks which are considered domestic along with Australian listed securities.*

Interestingly, regulatory issues played a role in delaying both the two mergers needing regulatory approval within our portfolio stocks. **Recall Holdings (REC)** delayed until March 2016 the meeting at which its shareholders are due to vote on the merger with Iron Mountain Inc., to allow regulatory approvals to be finalized. The NZ Commerce Commission ruling on the **Z Energy Limited (ZNZ)** acquisition of Caltex Australia Ltd in New Zealand was deferred to April 2016. It would appear regulatory bodies around the globe are unable to make timely decisions. There are $1.4TR of deals outstanding in North America, and 9 of the top 20 deals are trading at a discount of over 10% suggesting a level of uncertainty as to whether the deals will get through.

During December Woodside Petroleum (WPL) announced that they were no longer pursuing their proposed merger with **Oil Search (OSH)**. The OSH share price promptly retraced towards its previous lows, reflective of the weak oil price environment. It would appear as if WPL could not reach agreement with key stake holders, particularly the Papua New Guinea government, on the appropriate price and/or cash consideration component of the transaction. The attempt by WPL to acquire OSH confirms that OSH has some high quality assets.

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National Australia Bank (NAB) finalized the sale of 80% of MLC to Nippon Life, and confirmed the spin-off of Clydesdale Bank in early 2016. Both actions continue management's efforts to clean up the company's balance sheet and revert to its traditional strengths in Australia. These asset divestments, coming after the resolution of the commercial real estate problems in the UK, will lift the bank's ROE towards the mid-teens. From here the heavy lifting needs to be done by the core operations of the bank, in particular its business banking division which is slowly recovering from having lost its way over the last few years.

After raising capital for regulatory reasons, the four major banks all raised their interest rates by approximately 20bps in October, justifying this course of action as the result of having to hold more capital to cover loan losses. Perhaps the most interesting aspect of the industry's move was the fact that there was so little reaction from government – normally one would expect a round of "bank bashing" but on this occasion there was almost no negative sentiment forcefully expressed. Although we remain underweight the sector as discussed in previous quarterlies, we are cognisant of the powerful position of the banks in Australia and their importance to the economy.

Applying the ***CI VoF process***, the fund added a number of new ASX ex-100 companies to the portfolio while also taking the opportunity to increase certain existing positions and lighten or exit others. In assessing our new investments we continue to look for companies where we see value latency and a management team with a strategy, capability and balance sheet to realise that value. **Apiam Health (AHX)** was one such new addition. AHX provides veterinarian services and wholesale feed and pharmaceutical products to farmers in the pig, beef/sheep, dairy and companion animal markets. It was founded in 1998 by current CEO Dr Chris Richards who remains a major shareholder. Chris and his team have been successful in leveraging off their vet service network to cross sell wholesale animal feed and pharma products to end clients. We believe it has the strategy, network, personnel and balance sheet in place to realise further value by applying the same cross sell model to its recently acquired vet businesses while potentially adding to that network down the track.

Another growth company addition to the portfolio was **Xenith IP Group (XIP)** which is an intellectual property services practise operating as patent and trade mark attorneys and IP lawyers under the brand of Shelston Lawyers. The patent application market has delivered CAGR of 3% since 1996 which management has the potential to enhance by improving billable staff utilisation from current levels toward levels achieved by listed rival IPH Group (IPH). Given the low costs associated with any such improvement this could realise significant value latency for shareholders. Unlike litigation lawyers such as Slater & Gordon (SGH), XIP's revenue is generated via both hourly fees and fixed service charges effectively under a "do-bill-collect" model. These revenues are largely annuity like in nature given the trademark and patent lifecycles. While we favour management's conservative approach to growth, its strong balance sheet also presents opportunities for the company to consolidate the market in the manner we have seen from IPH Group.

In the three months to December the share price of **Australian Pharmaceutical Industries (API)** appreciated 27% on the back of a strong FY15 earnings release in October. The result was driven by +5% comparative sales growth in its retail network, continued expansion of store numbers to 420, the ability to hold gross profit steady in the pharmacy distribution business and an ongoing reduction in debt levels. While API's retail operations are Australian focussed, it is interesting that its vitamin and skincare sales grew 18% and 22% respectively over the year – with some of this likely being purchased by customers to take over to China to help meet the country's insatiable demand for high quality food and supplements. We continue to see latent value in the business as management drive positive comparative sales growth through leveraging its loyalty program, maintains its franchise network expansion and sustains its debt reduction program. In addition to earnings growth we also see potential for capital management initiatives in the form of special dividends which would release some of the value imbedded in the $38m of franking credits API has on its balance sheet.

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CSL Limited (CSL) held its Research and Development day in early December attended by market and banking industry participants. For the most part it was a positive update – from outside the company it is generally difficult to look deeply into or value the project pipeline, but over the years it has added a lot of value to the company. The new recombinant haemophiliac products it has been working on for some years are now not far from coming onto the market, and a number of other interesting new products (cancer, heart attack) are working their way through the clinical trial phases. Although we would not ascribe a lot of value to the earlier stage projects there are one or two that could be very large if successful.

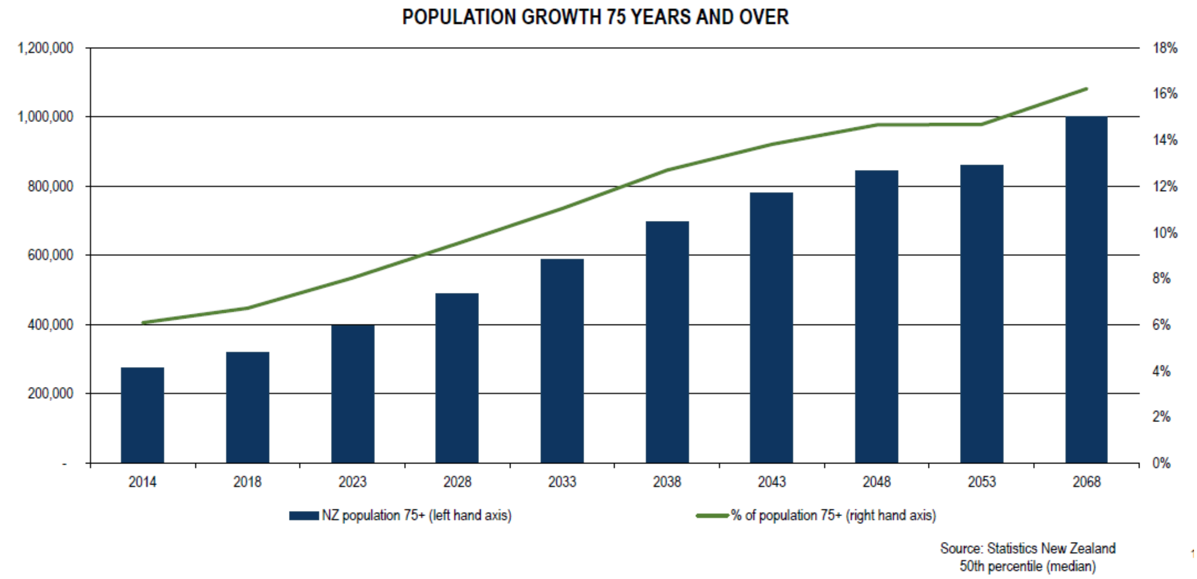
Industry Observations

Healthcare

Operators in the retirement sector have strong demographic tailwinds driving demand for their products and services. Over the next 20 years the ageing population, sometimes referred to as 'the grey tsunami', will result in the number of Australians aged 75 years and above more than double. The trends in New Zealand are similar with the population over 75 years of age expected to triple between 2014 and 2068 and, as in Australia, the demand for aged care beds is expected to exceed industry supply over coming years. These trends are particularly relevant for retirement village and residential aged care providers who have an average resident entry age of around 80 years.

There is also a large opportunity to provide affordable accommodation solutions to the ageing population given that 71% of Australians over 65 have no superannuation and will therefore retire on the pension. This is compounded by a limited availability of affordable housing in Australia. The number of Australians aged over 65 years is expected to double between 2005 and 2021, and double again by 2051. There is also an increasing trend to 'ageing in place' given budget pressures, shortages of aged care beds and Government policies, which we think will mean more Government initiatives to assist people stay in their home for longer. Manufactured Housing Estate (MHE) providers and rental accommodation models are well placed to capitalise on these trends.

The portfolio has exposure to retirement living and aged care through holdings in **Ryman Healthcare** and **Summerset Group**, and exposure to affordable housing via **Lifestyle Communities** and **Eureka Group**.



Source: Summerset Group

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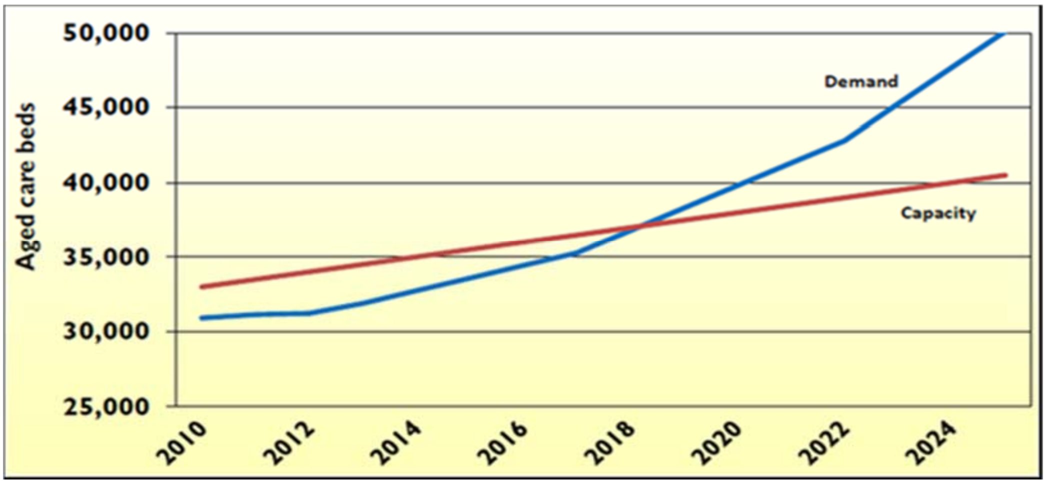
NZ Aged Care Bed Demand



Source: Ryman Healthcare

A number of regulatory reviews for the Australian healthcare system have been announced by the Government including the Medical Benefit Schedule (MBS), Private Health Insurance (PHI), chronic and complex care, and the Reform of the Federation White Paper. Finally, the Government is also working on a roadmap for the next wave of aged care reform via the Aged Care Sector Committee.

Federal Health Minister Sussan Ley's speech to the National Press Club in October identified that key objectives for these reviews are to remove inefficiencies and to reset healthcare policy via structural reform. Whilst it was made clear that these reviews are not about absolute cost cuts, our read-through is that healthcare providers will not be immune to the budgetary constraints imposed by government.

Sectors that will be impacted by these reforms include private health insurance, pathology, diagnostic imaging, medical centres, hospitals and aged care, and we expect funding pressures to be an ongoing theme for these businesses. The risks associated with companies that rely heavily on government funding for their income was highlighted in the recent Mid-Year Economic and Fiscal Outlook (MYEFO) which announced cuts to pathology bulk bill incentives, reduced incentives for diagnostic imaging and caps on aged care funding. This will impact companies such as Sonic Healthcare Limited (SHL), Primary Health Care (PRY), and Regis Healthcare (REG).

There are also risks for the private health insurance industry based on recent commentary from the Government considering the abolition of the 30% rebate on ancillary cover, an increased focus on the high returns providers are earning on effectively a mandated service, and a heighted political sensitivity to affordability issues around premium prices which are growing at more than twice the rate of inflation. These issues continue to make us cautious around the outlook for Medibank Private (MPL).

Any potential negative changes to the private health insurance sector would in all likelihood flow on to the private hospital sector. While we expect negotiations between the hospitals and the insurers to remain "robust" (as we have observed recently between Medibank and Healthscope Limited (HSO)), rather than the headline debate around hospital price rises relative to health insurance premium increases we see key areas for discussion between hospitals and insurers as relating more to the quality of and responsibility for procedural outcomes. In this context large private hospital groups which are able to secure the highest quality staff are best positioned. Another issue we are monitoring is any government initiatives around pricing of prosthetics which insurance groups are claiming is far too high. While there are many different views as to who is making what money out of prosthetics, we observe comments from both Ramsay and Healthscope that they do not make a material amount from prosthetics rather they simply pass their costs through.

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Oil & Gas

We recently participated in a site tour of **Oil Search's (OSH)** assets in PNG, which included the PNG LNG facility near Port Moresby, the Hides gas conditioning plant and the Elk/Antelope discovery; as well as presentations from a number of key executives from both OSH and their JV partners Exxon Mobil Corp (XOM) and Total S.A. (FP.FR). A key take-away from the site visit was the strength of ExxonMobil as a partner and the respect that they have for OSH as a contributor to the PNG operations. Exxon have deep global experience as an operator and developer in the oil and gas industry and they bring a rigour and military like execution to their operations. This however can at times be to the detriment of local sensibilities. One of the strengths that OSH bring to the venture, given their long experience in PNG, is providing a deep understanding of the specific local complexities associated with operating in PNG.

The production facilities visited have been built to a high standard and significant operating latency exits in the LNG facility, the upstream processor, and connecting pipelines. They appear to have been built with expansion in mind, as there is ample land and inbuilt capacity to enable expansion with significantly reduced capital expenditure requirements. This is encouraging for the economics of the proposed addition of another processing train to the current two train LNG facility.
At the time of our visit Exxon were also running a high rate production test at the facility and detailed some of the bottlenecks that they were working on resolving to increase production from the existing facility. The joint venture has already indicated that they will be producing at 7.7mt p.a. of LNG, more than 10% above the name plate capacity of the facility. Sustainable output at or above 8mtpa appears to be what they are striving to achieve. In discussions with the local management Exxon come across as a careful and disciplined operator.

The development of the Elk/Antelope discovery as the "Papua LNG" project is now being led by French company Total. This project is in the process of defining the reserves available before moving on to project engineering. The amount of gas reserves proved up will determine whether or not this development is a one or two train LNG project.

The current industry backdrop remains challenging for oil and gas companies. Oil prices have fallen more than 30% over the last 12 months on top of the 45% decline seen in 2014. This significant weakness has been brought about by a number of factors, including:

- The significant increase in non-OPEC supply, primarily the rise of US shale as a significant supplier into the market.
- The decision by Saudi Arabia to no longer act as the swing supplier and increasing supply, in what appears to be an effort to force out higher cost suppliers.
- Slower demand growth in both the developed and emerging world economies.

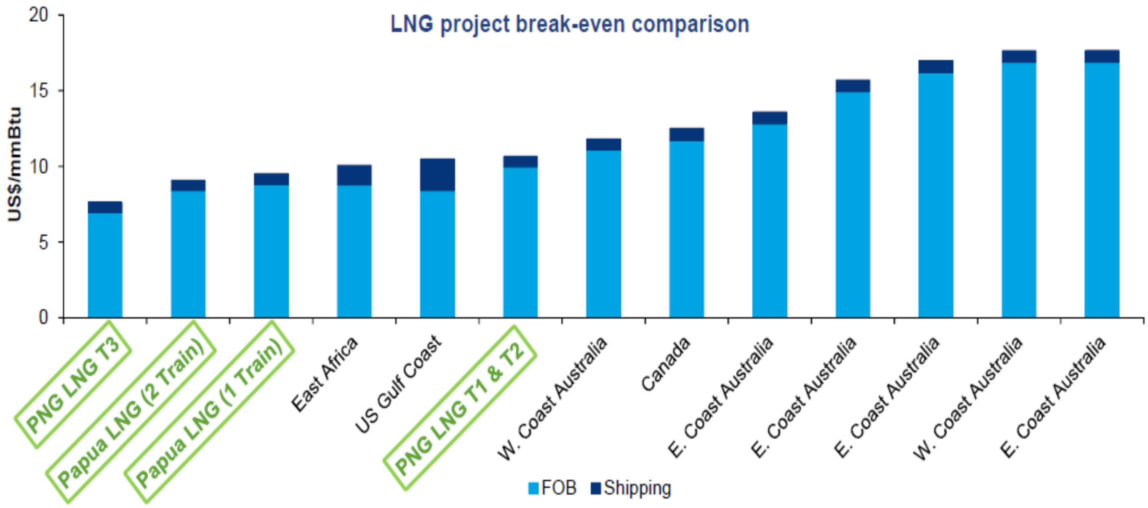
Oil prices now sit below US$40 a barrel making the development of many new oil and gas projects difficult. At current oil prices many new projects will struggle to make an economic return, while the effect of lower revenues and cash flow in the industry will constrict the availability of capital to develop new projects.

With a limited number of new projects being sanctioned and the natural decline curve of oil projects in current production, supply and demand will gradually move back into balance over the next few years. This decline curve is amplified for US shale oil, which experiences production declines of 45-50% in year one, meaning that significant capital expenditure is required to maintain production rates. Oil prices will eventually need to move back to a level that will incentivise companies to invest in new projects. Given the cost base of potential oil developments, in particular US shale, this price currently appears to be in the US$50-60 per barrel range.

The outlook for major LNG projects also looks challenged, with high up front capital requirements combined with the LNG industry heading into an unprecedented period of excess supply, as a large number of LNG projects in Australia and the US are either nearing completion or in ramp-up phase. While much of the LNG from these projects has been sold under long term contracts, a significant amount has been sold to parties who are not likely to be the natural end consumer of the product. With supply exceeding demand over the next few years, this excess LNG supply is likely to put significant pressure on prices in the spot market, making it even more difficult to secure long-term contracts with buyers at prices that will support the development of major new LNG projects.

It is in a weak industry environment that poorly positioned companies are exposed. Conversely, companies that have a strong balance sheet and cash flow, and projects that sit low on the cost curve have the most attractive characteristics from a VoF perspective. The balance sheet and cash flow enables these companies to continue to progress projects through periods of low oil prices while potential new projects at the low end of the cost curve provide significant value latency. These companies are best positioned to come out of the difficult industry environment in a stronger position. OSH has many of these attributes, which makes it stand out in a sector where companies are either under significant capital constraints and/or have limited growth options. Although both the PNG LNG Train 3 and Papua LNG projects have some way to go before a final investment decisions are made, they rank as two of the most attractive LNG developments globally (see figure 1 below) and OSH has world class joint venture partners in ExxonMobil and Total.

Figure 1: LNG cost curve



Source: Oil Search, Wood McKenzie, full-life breakeven, 12 % discount rate, shipping to Japan

Overseas Trips

We visited China again in late November. We wrote extensively about China in our September quarterly, and our findings on this latest trip only served to confirm what we learnt earlier in the year. The boom in China' economic growth, and demand for commodities, was driven off fixed capital investment, export growth fuelled by abundant cheap labour, and urbanization of hundreds of millions of Chinese being brought into the so called "middle class". A lot of this phenomenon was centrally debt funded with the result that government debt to GDP in China has jumped to circa 240%. The capacity and desire of the

Chinese government to continue further down this road is questionable. Thus we are seeing a transition to a more consumption and services based economy.

In the USA consumption accounts for approximately 70% of GDP, in China it is currently 36% - so they have a long way to go and it will not happen quickly. The slowing in demand in China has meant there remains overcapacity in many heavy industries – aluminium, coal, steel – which is leading to retrenchments in these industries. Indeed the chairman of one of China's biggest private steel companies was quoted as saying that China's steel production should be in the range of 600-700m tons rather than the current 830mt. As this unwind occurs the outlook for commodity prices is likely to remain difficult.

Global Observations

- European Capital Goods exporters are still cutting staff in emerging markets. E.g. Atlas Copco (Asia), Bureau Veritas (20% staff cut in Brazil);
- To do well in China western brands need a local sales force – "There is no Nielsen in China so you can go blind without your people on the ground";
- Old industrials have a great opportunity to participate in the coming 'Internet of Things' growth wave by re-engineering their products to be connected to networks;
- Nordic urban hubs like Stockholm and Copenhagen are seeing double digit population growth and mid-single digit GDP growth over the next five years, which contradicts the view that 'there is no growth in Europe';
- EU Banks willingness to lend is increasing. 10 years ago the Chairman of a local bank needed to give a personal guarantee to borrow €10mn – "now they ask how much do you want?";
- Good family-linked investment companies understand the importance of relationships with management and a long term view. "Relationships with CEOs of our companies is absolutely key. You need to trust the people running the companies. We don't invest in companies without having dinner with the CEO and understanding their relationship with money, how they react to adversity, etc." (French LIC);
- The ability to take a 5+year view with no concern around duration of capital or short term volatility is incredibly powerful;
- US is benefiting from broad technology hubs emerging outside California (e.g. SEI in Philadelphia, Tyler in Texas, Roper in Florida, Ansys in Pittsburgh);
- We are seeing the first moves of consolidation in US small and medium sized banks (NY community bank);
- In the Midwest it's all about having a cost cutting and productivity plan (e.g. General Mills, Ecolab, Mead Johnson);
- The US shale and energy boom was a bigger contributor to the recovery than originally thought;
- A number of companies are de-emphasising or pulling out of China (e.g. WW Grainger, Praxair, Interpublic) and we are seeing significant downsizing (Assa Abloy cutting 40% of Chinese staff and no expectation of recovery any time soon);
- This is the 3rd year of Emerging Market Fund outflows with 2015 being highest on record at US$63b;
- With China's ADR inclusion into the MSCI Asia it is now 72% of the MSCI Emerging Markets Index;
- Chinese outbound tourists has grown from 10m in the year 2000 to 109m in 2014;
- 464million households in Asia are now middle class of which 300million are in China;
- The Asian region still provides very little in the way of social security benefits. Both protection and savings products have huge growth potential.

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