CI BRUNSWICK FUND
QUARTERLY COMMENTARY REPORT

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

For current performance information please refer to the Monthly Performance Report.

DECEMBER 2016

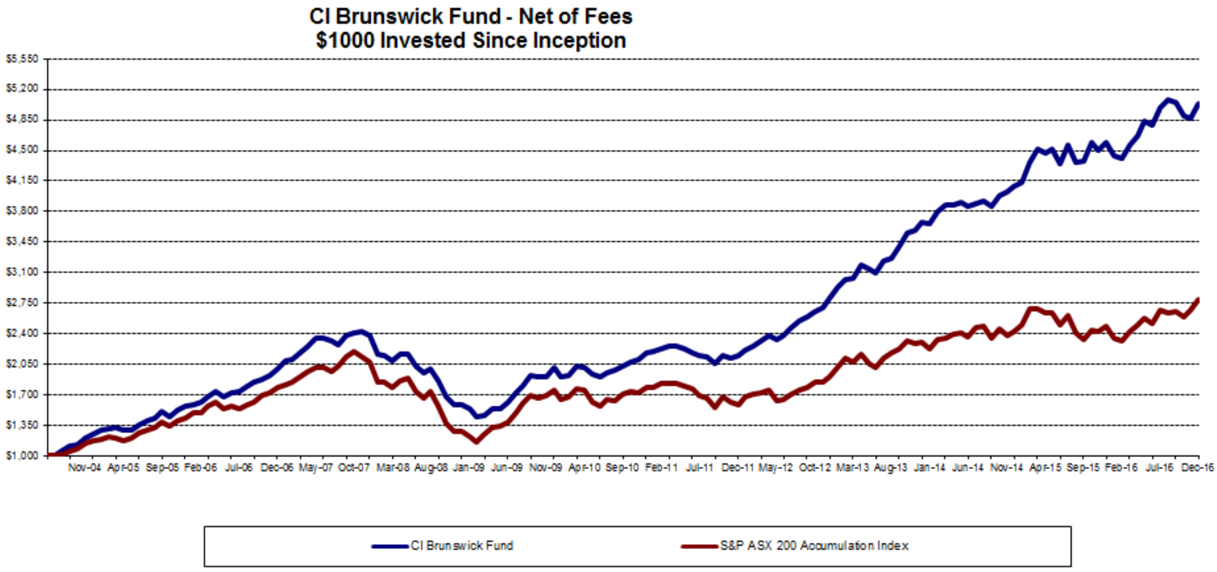
"The important thing is not to stop questioning. Curiosity has its own reason for existing." Albert Einstein

"Blind belief in authority is the greatest enemy of truth." Albert Einstein

"Indeed, if there is any one "secret" to an enduring great company, it is the ability to manage continuity and change—a discipline that must be consciously practiced, even by the most visionary of companies." James C. Collins

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	-0.03%	5.18%	-5.21%
ROLLING 1 YEAR	10.98%	11.80%	-0.82%
ROLLING 3 YEAR	12.84%	6.59%	6.25%
ROLLING 5 YEAR	20.54%	11.84%	8.70%
ROLLING 7 YEAR	15.97%	6.85%	9.12%
ROLLING 10 YEAR	11.69%	4.53%	7.16%
SINCE INCEPTION*	17.11%	8.53%	8.58%
SINCE INCEPTION^	620.31%	178.37%	441.94%

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



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Market and Portfolio Performance

The ASX200 Accumulation Index delivered another solid performance in the December quarter (+5.2%).

The portfolio performed poorly in the quarter, both in absolute flat and relative (-5.2%) terms. In essence this poor performance reflected both stock specific issues, as well as sector wide factors.

In terms of the stock specific issues, the key contributions to portfolio performance during the period included **Sims Metal Management (SGM)** (recovery in commodity prices), **Lifestyle Communities (LIC)** (no specific news) and **Commonwealth Bank of Australia (CBA)** (improved sentiment to the sector)**.**

This was more than offset by portfolio stocks that performed poorly during the quarter. These included **OHL Mexico (OHLMEX)** (US election impacting both currency and the outlook for growth in Mexico), **Boral (BLD)** (equity raising for the acquisition of US based Headwaters), **Apiam** (**AHX**) (weak Q1 driven by lower than expected herd numbers, particularly in Dairy) and **Ryman Healthcare (RYM)** (concerns about a turn in NZ housing, and the impact of rising US interest rates).

In November **Boral (BLD)** entered into an agreement to acquire Headwaters Incorporated for A$3.5b (US$2.6b). Headwaters is a US-based business that manufactures building products and is the leading marketer of fly ash (one of the most widely used construction materials in the US, mainly as a replacement for Portland cement). Headwaters appears to be a highly complementary US business for Boral given product and geographic overlap, as well as providing greater exposure to an improving US residential and infrastructure cycle that is still in recovery phase.

While we were expecting Boral to make an acquisition in the US, the size of the deal was substantially larger than we had anticipated. The acquisition price looks full at 10.6x EV/EBITDA but will be more reasonable at 7.5x EV/EBITDA if the targeted US$100m of synergies are delivered. It is clear that for this deal to stack up Boral needs the US recovery to continue as well as full synergy capture. The acquisition is expected to complete mid-2017 pending Headwaters' shareholder approval and US antitrust review.

Also during the quarter **Apiam** (**AHX**) announced weaker than expected sales and profit during Q1 FY17. This was a function of lower than expected herd numbers in both the feedlot business (impacted by a spike in beef prices and significant rain) and its Dairy business (herd cull was brought forward following challenges in Dairy markets). In addition, the pigs business was also weaker than expected as pig farmers brought forward some of their purchases in Q4 FY16 (largely because they were highly profitable in 2016).

Our view is that all of these factors are temporary. In addition, we believe there is significant value latency in AHX which relates to:

- Optimizing the existing business by improving mix, margins, and efficiency at the clinic and vet level.
- Driving product sales through acquired vets, with purchasing and scale benefits, including via private label products.
- Organic growth by further pushing into under-served areas.
- Further acquisitions of vets, clinics, and product categories.
- Geographical expansion (eg NZ).
- Expansion into other species.

Finally, and unlike many other CEOs post IPO, AHX's Chris Richards recently took the opportunity to purchase a material amount of stock on market.

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The portfolio's underperformance relative to the Index was principally due to its underweight positions in both resources and banks. Both of these sectors performed strongly during the quarter and we discuss this impact further on in this report.

In many ways the Index's performance during the quarter was a tale of two periods, marked by the election of Donald Trump as the next President of the US. In terms of the portfolio, the most direct impact was on **OHL Mexico** which operates toll roads in Mexico City. Investors became increasingly concerned about the impact of a Trump presidency on the economic output of Mexico (which could impact traffic on OHLMEX's roads). In addition, the Mexican peso experienced a meaningful depreciation relative to most other currencies.

Similar to "Brexit", President Elect Trump's election had not been widely anticipated, particularly by mainstream media. In many ways the election spoke to issues consistent with "Brexit", resonating with individuals impacted by globalisation and international trade.

Prior to Mr Trump's win, the Index had fallen -5%. It subsequently rallied +10%, with many global markets also rallying strongly. In part this appears to reflect expectations that the new President will:

1. Lower taxes
2. Increase spend on infrastructure
3. Remove red tape/ regulation.

While still too early to draw conclusions, we would observe that there are already signs (based on appointments to the incoming Administration) that Mr Trump's presidency will be more favourable to Corporate America, albeit with a potentially wider set of outcomes than the Obama presidency. In particular, a key issue for both China and therefore Australia is the potential impact of any changes made to US trade relations.

In addition to the election, the other significant event was the well flagged increase in US rates made by the US Federal Reserve. The Fed also outlined a series of anticipated rate rises for 2017. While this suggests the US is now in a rate hardening cycle, it is not yet evident that Australia is as well. It is also unclear what a decoupling of US/Australian rate cycles would mean.

This combination of events supported an improved outlook for Australian banks who could stand to benefit from a rising rate cycle, at least in the near term (improved outlook for margins). These events also supported the ongoing recovery in commodity prices and the Resources sector more broadly, from what now appears to be trough levels in early 2016.

The portfolio remains most underweight the Big 4 Banks, with only CBA still owned by the portfolio. One central characteristic of the Brunswick strategy is that the portfolio is 'unconstrained' by the Benchmark. We believe this has played a part in the portfolio's out-performance over the longer term, however, over shorter timeframes it can result in the portfolio underperforming.

The ASX200 Accumulation Index remains highly exposed to the Big 4 Banks, which combined with resource companies account for nearly half of the Index. In our view this concentration delivers a significant amount of risk.

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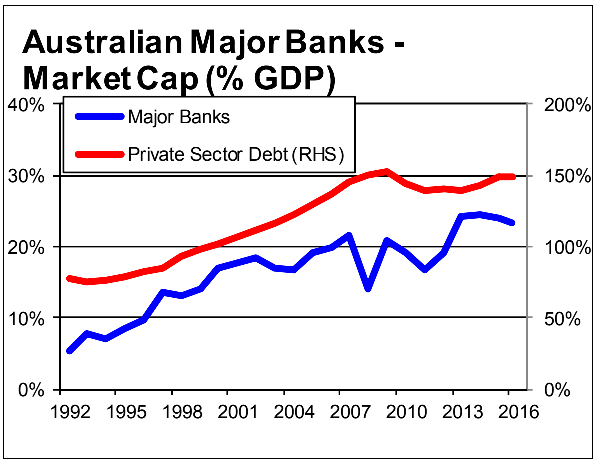
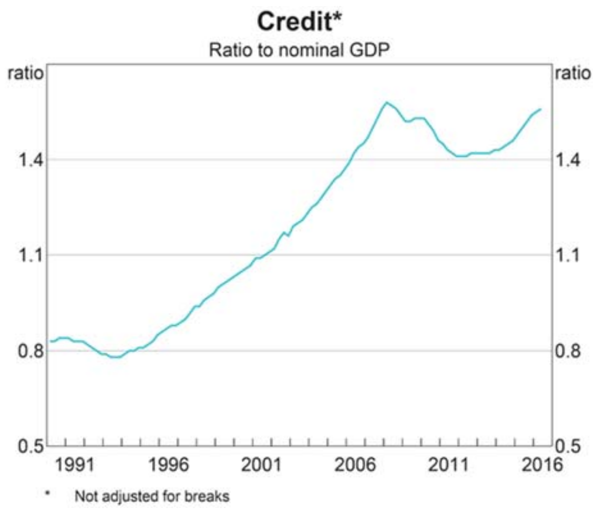
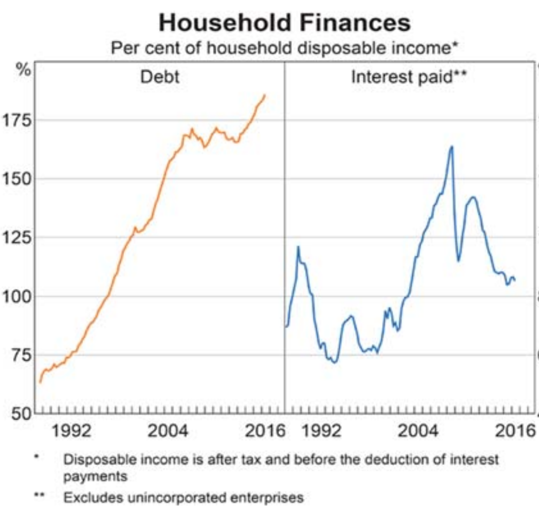
One key observation is that the banks' contribution to the total market index has grown significantly over time:



Source: Factset, RBA

Underpinning this is growth in private debt levels (debt as % of GDP, debt as % of disposable income), which largely reflects households "leveraging-up" as rates have fallen.





Source: RBA

This suggests that as rates rise, volume (or lending) growth could become challenging for the large Banks that rely on achieving something close to total loan growth. In addition, any increase in interest rates could also result in increasing bad debts, which remain at historically low levels (particularly if incomes remain stagnant or unemployment increases):

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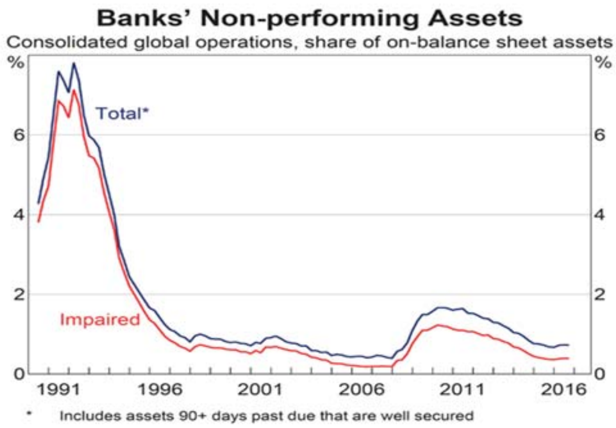


Source: RBA

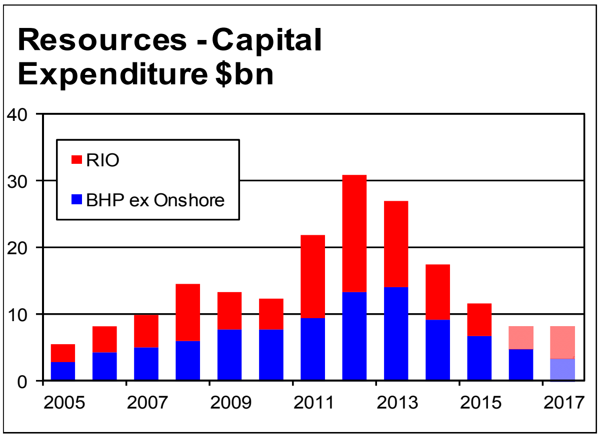
While the asset underpinning a large part of Bank lending is high quality (Australian property), over recent years we have arguably seen a deterioration in quality driven by strong growth in apartment builds, with a large dependency on potentially more fickle buyers (investors and foreign buyers).

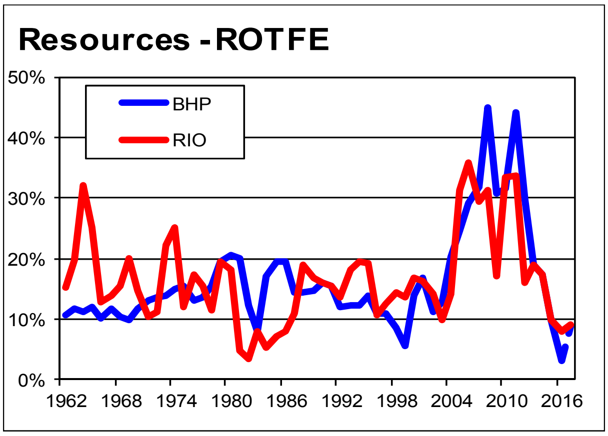
Given our "observation not prediction" philosophy we are not forecasting a collapse in property prices. Rather we observe that a significant concentration to this single issue is not particularly attractive in terms of portfolio risk/return over the next 5-10 years.

In addition, while we also continue to look for opportunities in Resource companies, they mostly fail the high bar we have set for investing in the "best of the best" focused management behaviour. These enduring characteristics include:

- Humility
- Focus and passion for the business
- Countercyclical investment
- Deep nuanced industry knowledge
- Proprietorship culture

As illustrated by the following charts, the large Australian miners have been more prone to hubris and pro-cyclical investment (capex peaks when returns peak):





Source: Company accounts

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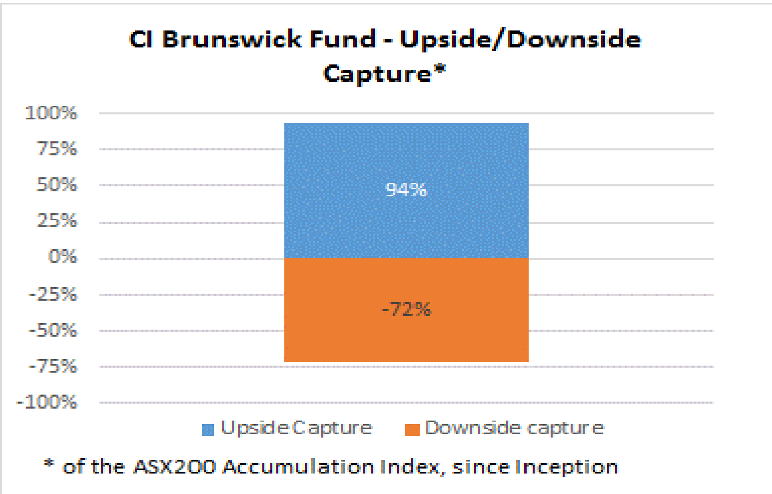
These behaviours unfortunately appear to be part of the culture. In particular, we remain concerned about the dispersion of decision rights across large senior management teams and Boards, with an associated loss of accountability.

Therefore, although this quarter's performance is disappointing, we remain focused on implementing our investment philosophy and "VoF" process that has delivered sound performance over the longer term.

In particular, our investment philosophy has contributed to the portfolio's outperformance in down markets. Over the life of the portfolio, we managed to capture 95% of the performance in up-markets, but only 72% of the performance in down-markets. The compounding impact of this is significant.



The Portfolio

The portfolio remains positioned around six stock clusters:

- **Stalwarts** (9% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (ASX)
- **Bond like equities** (11%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. (ALE Property Group, Auckland Airport)
- **Growth companies** (39%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Ryman, Freightways)
- **Asset plays** (11%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Soul Pattinson, Remgro)
- **Turnarounds** (13%) – sound businesses with good management in place and good balance sheets essential. We especially like spin offs and government to private turnarounds. (Clydesdale, Sims Metal)
- **Cyclicals** (7%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently. (Boral)
-

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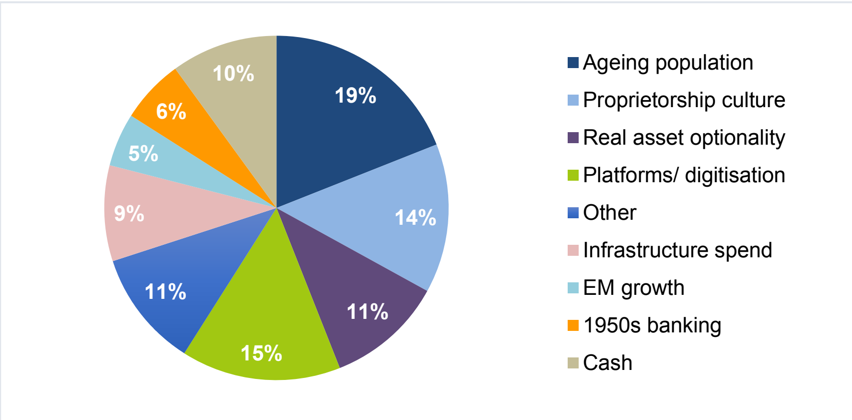
Currently the portfolio holds around 10% cash. The portfolio has around 13% of assets invested in overseas stocks that own businesses in Switzerland, South Africa, China, USA, Canada, UK, Singapore, Mexico and Hong Kong listed companies.

Portfolio attributes as at December 2016 are summarized below:

P/E	17.5
Beta	0.76
Yield	3.1
P/Book	2
ROE	11.6
Tracking error vs. ASX 200	5.69
Stock Number	36

We have also added the portfolio split by "Cluster" grouping:



Clusters define sets of companies that are exposed to particular industry, economic, demographic or other trends, as well as companies that share similar operating models or management styles. These clusters are an outworking of the "O" (operating, industry and strategic trends) in our VoF investment process. Clusters help us "fish in the most attractive ponds".

A cluster grouping that the portfolio has been increasing its exposure to is 'platforms/ digitisation'. These businesses are often technology based companies that have built businesses around assisting their clients migrate to digital processes.

To customers, this provides the ability to drive efficiencies, lower costs, reduce complexity (of internal processes or activities) and improve customer experience. As these 'platforms' become embedded in their customer's processes, switching costs increase. In addition, once the platform is built there is significant 'operating leverage' (higher margins are earned on additional sales) due to the low incremental costs to add new clients to the platform. For these reasons, we believe that many of these businesses are likely to create significant value over longer periods of time.

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In general, we favour the so called “vertical platforms” that have developed deep knowledge in a particular sector and have therefore embedded themselves within a particular industry’s processes or value chain.

One such vertical platform we took a position in during the quarter was **Iress (IRE).** IRE is a leading player in the wealth and financial technology sector in Australia, and arguably across the globe. IRE was formed in the early 90’s focused on servicing a networked group of clients (investment managers and “sell-side” brokers) in Australia. Over time this core business was complimented by acquisitions in the wealth sector, where its XPLAN product now dominates. More recently, IRE won CBA as a customer and will be rolling out its “XPLAN Prime” product early next year.

In recent years IRE has also grown its offshore presence by acquiring Avelo in the UK (also focused on the wealth sector). Avelo added a large customer base to IRE’s UK wealth business as well as software capability in mortgage broking. Over time we expect this business will grow further with the opportunity for convergence in wealth and financial markets customers.

The third leg to IRE’s business – Financial Synergy – was acquired more recently. Financial Synergy is the leading provider of administration software to the super fund industry. This will position IRE well in a sector that is attractive longer-term with the opportunity that IRE might one day provide some of its wealth products direct to many Australian’s via their super funds.

Although as previously explained the portfolio remains underweight the big 4 banks, we have been building up exposure to a cluster we call “1950’s banking”. In short, these banks have gone back to basics with a proposition focused on service and smart use of technology to help lower costs.

One addition we made to the portfolio, which falls within the “1950’s banking” cluster in Australia/NZ is **Heartland Bank (HBL)**, a niche, focused, second-tier bank based in Auckland. HBL continues to grow at rates well ahead of system/peers by focusing on niche areas of the banking market where the large banks aren’t competing as aggressively.

Under CEO Jeff Greenslade, HBL runs a lean yet focused management team targeting segments such as car finance, reverse mortgages, SME lending (at the smaller end), rural lending, and an emerging interest in a P2P platform ‘eHarmoney’. HBL’s niche strategy has helped it deliver higher ROAs than the large banks over time. These higher ROA’s also mean it has been able to run a much more conservative balance sheet (Liabilities/Equity of 6x vs 20x for the big 4). Over time, we expect HBL can grow its asset base well above total banks’ loan growth and unlike most large banks, also improve its ROTE.

The Fund initiated an investment in **The Brink’s Company (BCO.US),** a leading cash handling business listed in the United States. Brink’s has been chronically mismanaged for the best part of a decade resulting in growth rates and profitability well below peers despite scale and product mix advantages. We were initially attracted to the Brink’s story following the appointment of Doug Pertz as CEO in mid-2016. We knew Doug from his time at Recall, a successful low-risk turnaround investment which we previously held. As an underperforming, global, route-based business services company Brinks presents an almost identical opportunity to that of Recall.

Our framework for low-risk turnarounds dictates that we must be able to identify a clear and measureable operational self-help opportunity. BCO’s US business accounts for a quarter of the company’s revenues yet operates at close to breakeven. Our research indicates that correct investment in technology and best practice processes will go a long way to closing the profitability gap to similar sized U.S. peer Loomis, which generates double digit margins.

This is not just a cost-out story - the pursuit of high value growth opportunities represents a further key source of value latency. Previous management teams pulled sales resources so as to hit short term profit targets. Our discussions across the industry confirm the high returning growth opportunities in Cash Management Services with both bank and retail customers.

It is worth highlighting that despite the advent of electronic and card based payment methods, cash in circulation across developed markets continues to grow. In emerging markets such as Latin America (~60% of BCO's earnings) the cash economy is growing at upwards of 10%. We are not predicting the return of cash as the sole method of payment, however it will remain an important and growing medium of exchange for the foreseeable future.

The "Exemplars" Case Study – "Best of the Best" Focused Management Behaviour

As an addition to this Quarterly Report, we intend to provide some more detailed discussion of one of the portfolio companies each quarter. We have called these companies "exemplars" as in our view they represent the "best of the best" when it comes to focused management behaviour, the "F" in our "VoF" investment process which we think is particularly important to the portfolio's outperformance over the long-term.

Washington H. Soul Pattinson (SOL)

The Soul Pattinson Company has a long corporate history, incorporated in 1902 and listed on the Sydney stock exchange in 1903. Predecessor firms date back even further when Caleb and Washington Soul opened their first store in 1872. As stated by the company:

"Over 110 years as a public listed company – Washington H. Soul Pattinson and Company is one of the few successful public companies that has been managed by the same family from the outset - and therein lies the key to its strength.

Its leadership has been grounded in successive family members, who value the history of the company, yet are able to adapt to changing times and economic conditions. All have had the ability to spot talented people to fill senior and middle management roles.

In turn, management has always been supported by able, loyal, and long-serving staff. More than 40 employees have worked with the company for over 50 years. Five generations of the Pattinson family have served the company, as have three generations of the Dixon, Spence, Rowe, and Letters families.

Washington H. Soul Pattinson and Company Limited is now a significant investment house with a portfolio encompassing many industries – its traditional field of pharmacy as well as retail, building materials, natural resources, equity investments, agriculture, telecommunications and corporate advisory."

In many ways it's hard to better articulate what we look for in a management team. In particular, the history, family connection and long-term thinking of management are in our view strongly aligned to long-term shareholder value creation.

However, in our experience these types of companies can also go through periods (sometimes years) of underperformance. In SOL's case this has happened recently:

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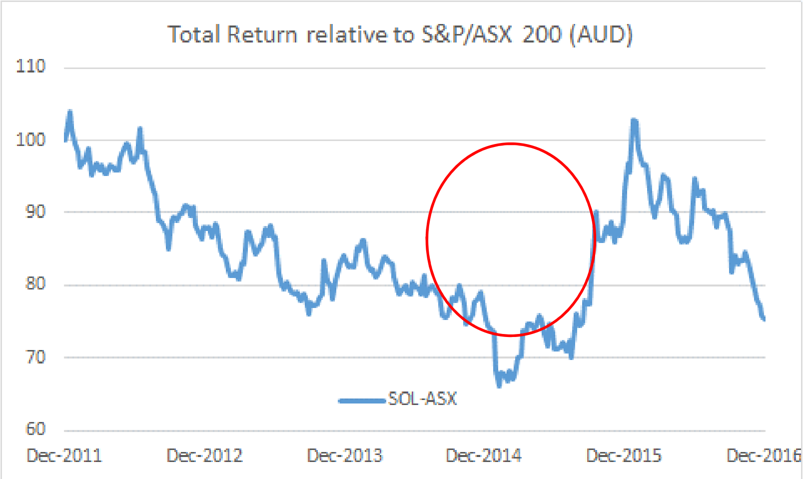
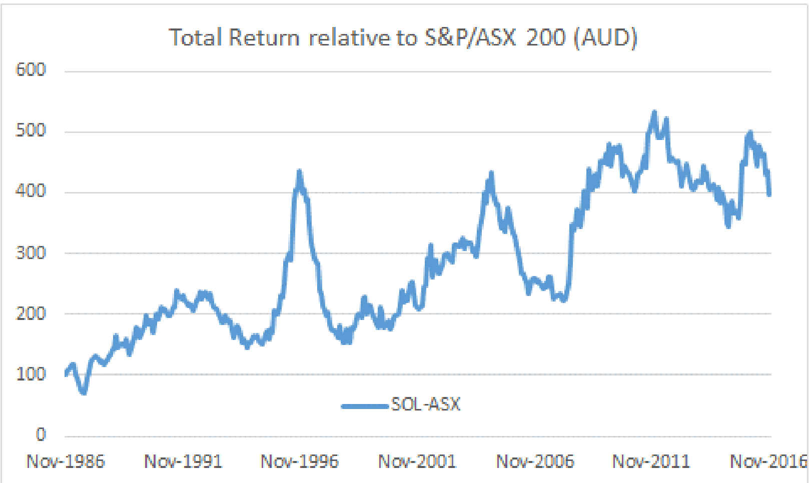


Over the past 5 years, some of SOL’s businesses have faced challenging conditions. For example, New Hope, as commodity markets normalised. More recently, and following many years of substantial outperformance, TPG Telecom faces a number of challenges relating to the NBN and potential upfront investment in mobile spectrum.

During this time the group has also faced challenges around its corporate structure, with some arguing that the cross holding with one of its biggest portfolio companies Brickworks was a barrier to unlocking shareholder value. While this might be true in the short term, unwinding this structure would clearly undermine the ability of the SOL group to generate value over the long-term given its history of making counter-cyclical investments and its longer-term focus. This is evident in SOL’s out performance relative to the Index over a long time frame:



Of particular interest to us is the observation that on multiple occasions the stock significantly outperforms in down markets. This downside protection is invaluable, and our experience is it is best to hold these types of stocks long-term to avoid missing the most important periods of out-performance.

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Industry Observations

General Industry Observations

- The Homecare Services industry is set to undergo significant regulatory change in 2017:
  - The government is increasing the number of high care packages that will be funded in the home.
  - There is also a shift towards a patient or customer funding model.
  - The government is making it easier for new providers to enter the sector.
  - There are significant synergies with the types of services that will be provided under the NDIS.
- Demographics will start to materially impact the number of hospital admissions:
  - 80 year olds have 4 times the admission frequency of a 50 year old patient.
  - Length of stay is also much higher for an 80 year old patient (bed days are 10-15 times higher).
  - The first wave of baby boomers are now turning 70.
- Data is growing at a phenomenal pace:
  - There are now 16bn devices globally sending data. This will increase to 40bn by 2020.
  - 90% of the world's data was produced in the last 2 years.
- Financial technology companies ("FinTech") remain of interest to many investors given their potential to disrupt the large profit pools of the banks and other financial companies.
  - $150bn has been spent globally since 2010, $25bn in the last year.
  - Australia has 9 of the 100 top fin tech companies globally, making it the 4th most represented country.
  - 30 of the top 100 fin tech companies are in lending.
  - Investment is attracting talent globally

Trip Notes

During the quarter we made a number of domestic visits to Brisbane, Sydney, Perth and Adelaide. Our recent visit to Perth highlighted that the recovery in commodity prices is yet to have a material impact on the WA economy:

- CBD office space continues to run at very high vacancy levels (25%). West Perth is also problematic with some businesses using the downturn as an opportunity to move from West Perth to the CBD.
- Detached housing approvals continue to fall (13k based on the October run rate) to levels below mid-cycle (which is probably closer to 15-16k).
  - This fall in approvals has particular relevance for two portfolio companies –Brickworks (BKW) owned indirectly via the portfolio's holding in Soul Pattinson (SOL) and Boral (BLD). Both companies compete in the WA brick market (which is dealing with a fall in demand and over-capacity) as well as the east coast brick market (which continues to perform strongly in the face of a large construction boom).
  - While we were in Perth we visited Brickworks. Our view is that management displayed all the characteristics desired by us: deep, nuanced knowledge of the industry, humility, and countercyclical investing.
- Cabs are now much easier to find (even adjusting for Uber!).
- Some of the large miners still appear to be making redundancies.
- On the positive side, it appears that the improvement in commodity prices has assisted many of the marginal producers to stay in business.
- A number of players with stronger balance sheets have managed to make some investments at what appears to be the bottom of the cycle.

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