CI BRUNSWICK FUND
QUARTERLY COMMENTARY REPORT

COOPER INVESTORS

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

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

JUNE 2016

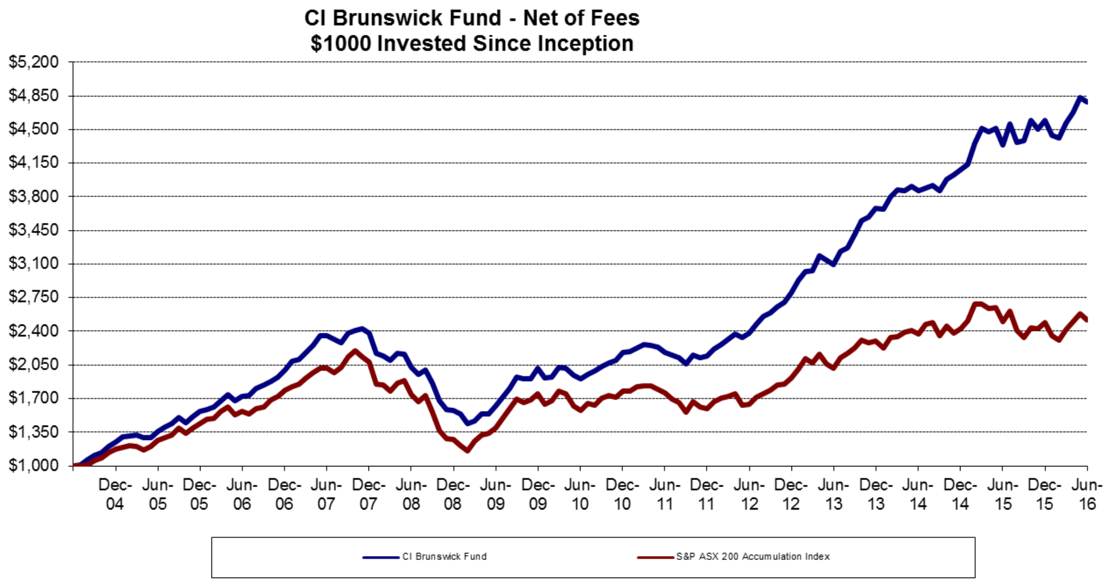
"Imagination is more important than knowledge. For knowledge is limited to all we now know and understand, while imagination embraces the entire world, and all there ever will be to know and understand." Albert Einstein

"Those who would give up essential Liberty, to purchase a little temporary Safety, deserve neither Liberty nor Safety." Benjamin Franklin

"I fear not the man who has practiced 10,000 kicks once, but I fear the man who has practiced one kick 10,000 times" Bruce Lee

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTH	5.06%	3.94%	1.12%
ROLLING 1 YEAR	12.46%	0.56%	11.90%
ROLLING 3 YEAR	17.68%	7.66%	10.02%
ROLLING 5 YEAR	19.30%	7.40%	11.90%
ROLLING 7 YEAR	18.75%	8.81%	9.94%
ROLLING 10 YEAR	13.04%	4.86%	8.18%
SINCE INCEPTION*	17.33%	7.99%	9.34%
SINCE INCEPTION^	580.39%	151.70%	428.69%

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



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Market and Portfolio Performance

As a result of the UK's referendum vote to exit the European Union ("Brexit"), the ASX200 Accumulation Index fell 2.45% during the month of June. The vote highlighted a number of schisms in the UK including regional differences (only London, Scotland and Northern Ireland voted to remain) and demographic differences (young people voted to remain). The key concern for markets is uncertainty around the impact of Brexit on economic growth and the flow-on impact on the structure of the EU. However, the Index still finished up 3.9% for the quarter even after the impact of Brexit.

The Fund's holding in **Clydesdale Bank (CYB)** was particularly impacted by the leave vote. However, **CYB's** strong performance in the months prior meant the stock was still up 7% (AUD) for the quarter.

Key contributors to positive performance during the quarter were **Z Energy (ZEL)** (successful merger with Chevron NZ), **Eureka Group (EGH)** (acquisition of villages), **Equity Trustees (EQT)** (new management and refocus of business), **Lion Selection (LSX)** and **Aurizon (AZJ)** (recovery in commodity prices). Portfolio stocks that performed poorly were **Murray Goulbourn (MGC)** (lower commodity prices driven by industry supply issues and optimistic estimates of Chinese demand for milk powder), **OHL Mexico (OHLMEX) (**loss of key staff), and **Australian Pharmaceuticals Industries (API)** (poor cash conversion in its 1H 16 result and a slow-down in same store sales).

The Portfolio

The portfolio remains positioned around five pillars or stock clusters:

- **Stalwarts** (22% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (Brambles, Wesfarmers)
- **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)
- **Niche growth companies** (33%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Vitasoy, Summerset and Ryman)
- **Asset plays** (13%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (OHL Mexico, Jardine Strategic, Soul Pattison, Remgro)
- **Turnarounds** (12%) – 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** (4%) – stocks showing both upside and downside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently. (Boral)

Currently the portfolio holds around 3% 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 June 2016 are summarized below:

P/E	16.95
Beta	0.81
Yield	3.29
P/Book	1.81
ROE	10.59
Tracking error vs. ASX 200	4.86
Stock Number	40

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Clydesdale Bank (CYB) was most impacted by the decision to exit the EU, falling 25%, in line with other UK banks, and is now back to a little above its demerger price six months ago. The thesis for buying the stock has not changed but the external environment may now prove to be different to what we originally anticipated. The company has a large cost out opportunity (its current cost/income ratio is 75% compared to peers at 55% or less), an opportunity to utilize excess capital over time, and with only circa 2% market share in the UK, the opportunity to grow at the expense of the major banks. Any slowing of the economy as a result of the Brexit vote may impact on the latter point but would likely lead to an acceleration of the first two.

Murray Goulbourn (MGC) announced a large earnings downgrade during the quarter, due to low commodity prices, lower dairy product sales than anticipated and a higher AUD than anticipated. As a result of the above, the milk price payable to the company's farmers was reduced and a milk supply support package introduced. The CEO resigned immediately.

During the quarter **Australian Pharmaceuticals Industries (API)** reported a solid 1H 16 result (Revenue +4%, EBIT +16%). However, operating cash flow was poor following an investment in inventory prior to upgrading its SAP system. In addition, same store sales growth was below levels recently experienced, although it remains solid overall (low to mid-single digit). While the stock has fallen since the result, it now trades at a significant discount to peer **Sigma Pharmaceuticals (SIP)** which we don't believe is justified. Over the medium term, we are confident in API's ability to unlock value by continuing to grow its base of Priceline stores.

In addition, **Equity Trustees (EQT)** CEO Robin Burns resigned and Director Mick O'Brien was installed as interim CEO (now permanent CEO). This followed the company's poor result in 1H 16. Positively, Tony Killen announced he would stay on as Chairman for the near term. The new management team which includes recently appointed CFO Philip Gentry, moved to quickly steady the ship hosting an investor day in June, where they outlined a review of the group's operating model and an increased focus on near term growth from its large Wills' Bank and in its Corporate Responsible Entity business. Equity Trustees has a long history of providing the highest level of service as fiduciary in estate planning, wills, philanthropy and corporate trusts. It has a strong and trusted brand with significant value latency.

Vitasoy (345 HK) also recorded a solid full year result with revenue up 10% (13% in constant currency terms), with China particularly strong (+29%, constant currency). In addition, a slight improvement in margin saw EBITDA up 12%, and with a lower tax rate both NPAT (+43%) and the dividend (+24%) grew significantly.

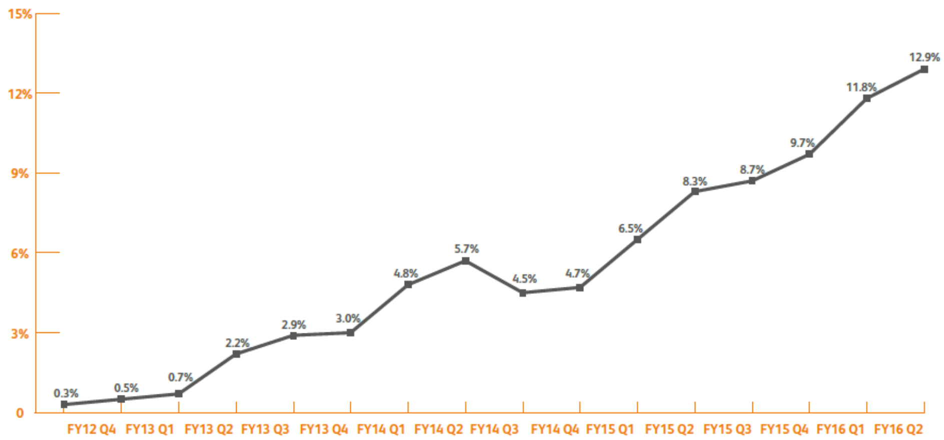
We participated in the rights issue for **Clearview Wealth (CVW)**, undertaken to pay down group debt and prepare for a likely exit of private equity owners Crescent Capital (51.5% of shares outstanding). The Board of CVW and Crescent Capital appointed Morgan Stanley to review its options for the sell-down. We continue to believe CVW is well placed to benefit from an increasing need for independent Life Insurance and Wealth products, differentiated from larger institutions. During the quarter, we also participated in the placement of shares for **Eureka Group (EGH)** which the group will use to acquire additional villages.

We initiated a number of new positions in the Fund during the quarter. The first was NZ listed **Freightways (FRE)**, a leader in the express parcel and business mail market in NZ. This market is leveraged to economic growth and is largely a duopoly with NZ post with high-density routes for the scale players. FRE's multi-brand strategy, scale and scope has created a solid entry barrier. Despite some risk of technology disruption (e.g. Uber parcel and drone operators) we expect FRE will continue to enjoy strong tailwinds from growth in parcel volumes in B2C (online deliveries) and B2B, at rates above the broader economy.

In addition to its parcel and mail operations, FRE also operates in the Information Management sector, which we know well from previous investments in **Recall (REC)**, and our current holding in **Iron Mountain (INM)**. FRE scores highly in CI's "VoF" framework given the opportunities the company has to deploy capital in its main businesses. In addition, CEO Dean Bracewell and CFO Mark Royle are both industry veterans and have a long history with the company. They have delivered a focused and conservative strategy with an exceptional track record of deploying capital at good rates of return over time.

The fund also made an investment in **iSelect (ISU),** an established player in what is referred to as "online aggregation" in the UK/US, or in ISU's case "digitally enabled broking". Importantly, iSelect's model requires sales staff to convert inquiries via a call-centre whereas traditional aggregators utilise a pay per click model. ISU initially targeted the Health Insurance sector given the significant number and complexity of products (more than 40,000). The company has more recently built out related product "verticals" in Energy, Telecoms (including NBN), General Insurance (Home, Car), Mortgages, Super and other products. Increasingly, ISU has been able to cross-sell across these verticals:

ISU Cross-sell for Product Verticals



Source: iSelect Presentation

Over more than 10 years the company has built a brand and business with significant entry barriers. ISU's size affords it scale in both marketing spend and its investment in IT. This has helped create a network effect where product providers attract customers to the site which in turn attracts product providers, creating a barrier to new competitors. Over the years it has gathered substantial amounts of data on customer preferences, needs, switching criteria, pricing points and their provider's products. This data has been internally "mined" to optimise sales techniques which are increasingly embedded into its systems and processes. Longer-term, ISU has the potential to become a very important channel for large profit pools earned by insurers, banks, energy and utility companies. Although ISU has suffered mixed performance since its IPO in 2013, primarily due to a number of issues relating to operations and staff, we are increasingly confident these issues are now behind the company.

We also initiated a position in **Steadfast Group (SDF),** a mid-market insurance broker. Insurance broking remains a people centred business with SMEs in particular seeking advice on complex insurance products. Unlike underwriters, brokers assume no risk on claims. Instead they charge a fee for service, historically linked to premiums but increasingly at fixed rates making them less sensitive to insurance cycles. SDF's CEO, Robert Kelly was himself a broker with 40 years' experience in the industry and has built SDF over the past 15-20 years. Arguably, Robert has no equal in the industry given his knowledge and contacts. Luckily for the business, Robert has extended his employment contract through to 2020.

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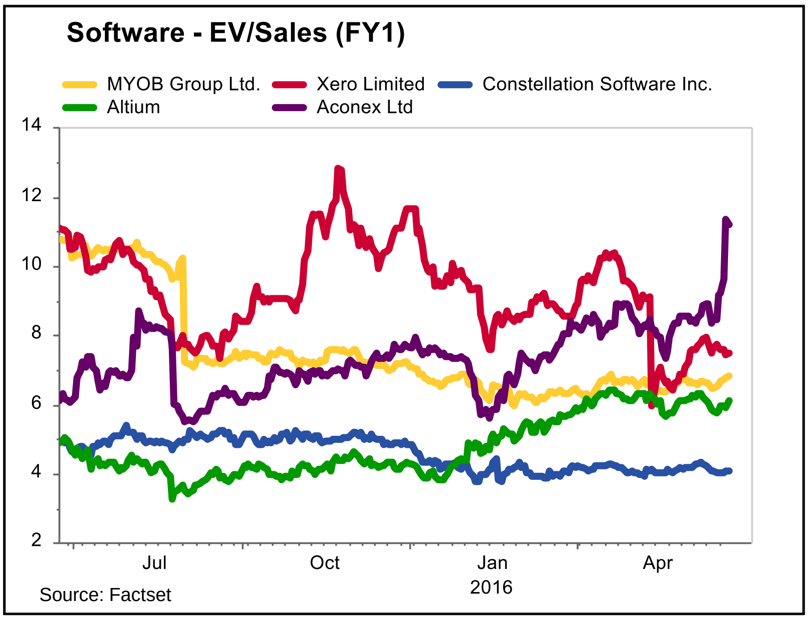
Robert and his team recently unveiled a number of new IT systems they have spent the last few years developing. These systems will be used to generate real time quotes from underwriters and to help manage broker client data. We expect this will provide significant support to the group's ongoing efforts to consolidate the industry given the compelling proposition it provides to brokers and agents to come into and remain in the network.

Lastly, we also initiated a position in Canadian group **Constellation Software (CSU),** a stock currently owned by CI's Global Fund. One of the advantages of the Brunswick Fund is being able to pivot between investing in small and large cap Australian equities and between Australian and international equities.

One glaring weakness of Australia's equity market is the lack of large stalwart Technology companies like Microsoft, Google, IBM, SAP and Intel. However, Australia does have a number of emerging software companies such as MYOB, Xero, Altium and Acconex. Given both the expected growth profile of these companies and their relative scarcity in the Australian market, these companies trade at very high multiples of sales (6-11x):



(Note: we use sales multiples for comparison to normalise for lower margins earned by companies still growing to a steady state position)

While over the longer-term these multiples might end up being justified, our view is that there is fairly significant execution risk in these stocks.

In contrast, Constellation Software trades on a more reasonable multiple of sales (4x). It is much more diverse by geography and industry verticals (and product which largely fits the end customer), while still remaining a focused business (enterprise/application software). The company has a proven track record of growing sales, profit, free cash flow and invested capital over the past 15 years. It has a proven track record of capital allocation through over 100 acquisitions where it generally pays very conservative multiples (3-4x EBIT). Over 20 years, CEO Mark Leonard has developed a particularly strong culture of success. In short, Constellation Software provides a portfolio investment of small software companies that could only be acquired at much higher multiples in Australia by purchasing a number of separately listed companies. In our view this provides a much more attractive risk/return profile than a single bet on a single company/industry in more limited markets.

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Market Observations

The Brexit vote in the UK late in the quarter has engendered plenty of differing views, both as to why the vote went the way it did, and what the ultimate outcome might be. We find it difficult to add much to the reams already written but would observe that Central Banks have unwittingly or uncaringly contributed greatly. The amount of so called quantitative easing, bond buying and lowering of interest rates undertaken over the last few years in order to push liquidity into the system in an effort to generate economic growth has ultimately had the exact opposite impact to that intended. The effect of these actions has been to:

- Increase asset prices (equities, bonds, property);
- Reduce the amount savers and retirees have to spend;
- Sadly, not increase economic growth; and thus
- Exacerbate the perceived (and real) level of inequality in global society.

If one then adds in globalisation, unemployment, lack of wages growth and immigration trends, it is no wonder there is a protest vote by those who have been affected – as seen in the Brexit vote, the rise of the far right party in France, the spectacular success of Donald Trump in the USA, and even the relative lack of popularity of the major parties in the Australian election. While the Western world is not in a recession, economic growth rates are very low. Government balance sheets are stretched and most are running budget deficits. There is little latency to deal with a left field event leading to recession.

We must now be very close to a point where Central banks will need to reassess their policies – keep on pushing on a piece of string or reverse course and start to normalise interest rates (the Swiss 50 year bond yield went negative this week). Either course is fraught with risk. Very low, falling and negative interest rates, if a harbinger of deflation, would not be positive for highly geared structures, pension funds and insurance companies, and not good for banks' profitability. Equity valuations have typically been based on bond rates – using current interest rates is close to meaningless in this regard. And any rise, or perceived rise in interest rates will, given the levels of debt involved, also likely be negative for asset prices.

There are many possible, and indeed likely, reasons for the UK having voted as it did. One of them is exemplified the world over – that of increasing regulatory and tax imposts in many parts of the economy. The latest Economist shows that of 43 of the larger economies of the world, only five run a budget surplus. Sadly Australia is not one of them, and in all likelihood our budget and government debt position will get worse (perhaps substantially so) before it improves. It is perhaps why tax imposts continue to rise and government funding to industry remains tight. In Australia we have recently seen:

- The funding to aged care cut in the latest Budget;
- The South Australian government propose a point of consumption tax on wagering in the state, potentially paving the way for other states to follow;
- Ongoing tobacco tax increases;
- Both parties in the pre-election battle backing away from committing funding to healthcare.

The point of the above is that it is getting more difficult for business to operate – at a time when global growth remains stubbornly low and episodes like Brexit only serve to exacerbate this issue. This will continue to put a premium on companies who can continue to grow earnings, cashflow and dividends without risking the farm to do so.

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Trip Notes

During the quarter we visited a number of industry participants related to the pallets and Reusable Plastic Container (RPC) industries across the United States with reference to the outlook for **Brambles (BXB).** In particular, we wanted to test our views on the potential size and longevity of the US pooled pallet and RPC markets and how the company is managing growth in these areas – areas we see as critical in BXB achieving its FY19 20% ROIC target. This was particularly important after periods where BXB incurred cost challenges within its US pallets business while also recently losing a sizeable RPC customer.

A key takeout was that BXB is the clear market leader in pooled pallets but is not dramatically lifting prices. While such price hikes would be aesthetically pleasing to BXB's short term results, we believe it would be very detrimental to the value of BXB's network and therefore long term earnings. Rather than pricing, BXB is using its expertise to attempt to move into new client segments such as auto after care or pet care products while also increasing the product lines it services within its retailer client networks. We also came away with a sense that the initiatives around rolling out clinch nails and nail plates across their pool should support product durability which over time, assists margins in a growing revenue environment. In terms of the US RPC offering, despite the loss of a key client in 1H16, BXB appears to be gaining significant momentum as growers and retailers gravitate to its offering versus traditional cardboard. As it continues to grow scale we believe management are creating significant long term shareholder value which over time could be as large as its current European RPC business.

We also visited Asia during the quarter, which included seeing **Boral's (BLD)** plasterboard JV, USG Boral. The business has tangible long term growth potential as plasterboard adoption rates increase across the region. Plasterboard consumption rates are low at 1-2 sqm per capita versus developed economies at 6-8 sqm. The potential for an increase in consumption rates can be illustrated by Singapore, where it has increased from around 1 sqm to 4 sqm per capita over the last 5 years.

Plasterboard has significant advantages in terms of weight, ease of construction, thinner profile and environmental footprint, relative to bricks, the key competing material. The main impediments to penetration appear to be the total installed cost differential between plasterboard and bricks and mortar, and the, largely unjustified, perception of the relative build quality of plasterboard in terms of solidity, acoustic properties and finish. As well as working to increase the penetration of plasterboard in the region, management are also aggressively pursuing growth in adjacencies such as metal fixtures & fittings, adhesives, acoustic tiles and water resistant products.

Although recent years has seen economic growth slow in a number of countries in which they operate, USG Boral continues to grow revenue at double digit rates, and increase margins and returns. Management are very focussed on driving adoption rates and staying ahead of the competition, leveraging off the innovation and R&D capabilities of their partner USG.

Amendment to Constitution

The Australian Government has enacted legislation which establishes a new tax regime for managed investment trusts that qualify as attribution managed investment trusts ("AMIT"). Cooper Investors intends to elect to apply the new AMIT regime from 1 July 2016. Under this new regime, taxable income will flow through to unit holders on an attribution basis, rather than a distribution basis and it will also facilitate Cooper Investors allocating realised capital gains arising from the sale of assets in order to fund a significant redemption to the redeeming unit holder. This is instead of a pro rata distribution of realised capital gains based on unitholdings.

In order for the Fund to be operated in a manner permitted by the AMIT regime, Cooper Investors has amended the Constitution of the Fund.

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