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.

JUNE 2017

"Nothing is so permanent as a temporary government program." **Milton Friedman**

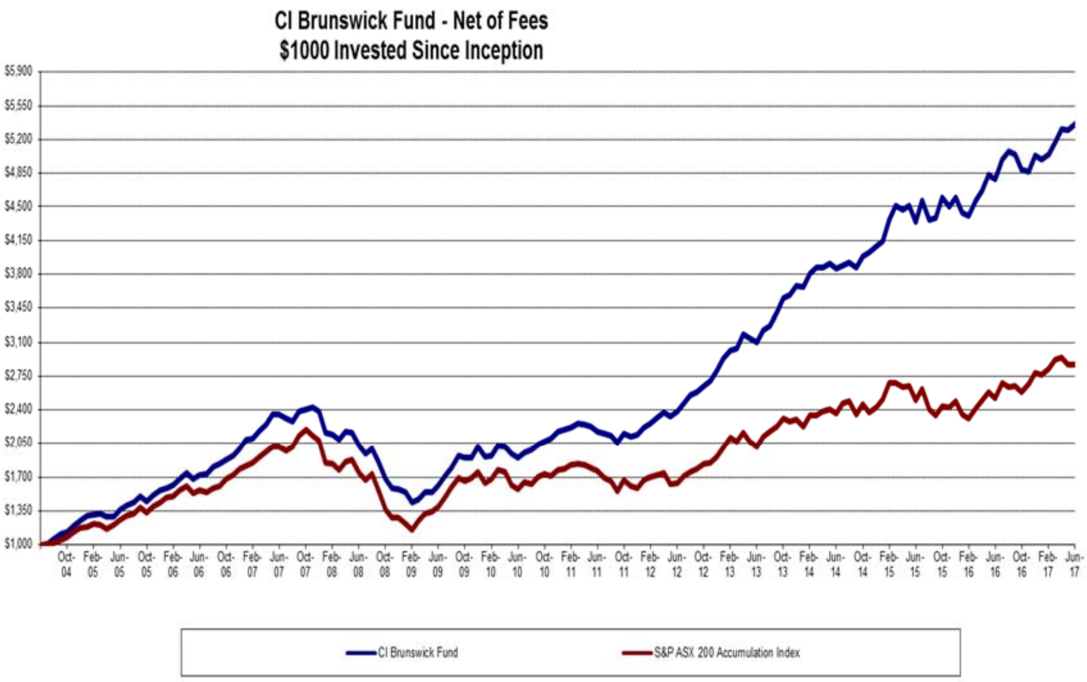
"I think the government solution to a problem is usually as bad as the problem and very often makes the problem worse." **Milton Friedman**

"Free enterprise incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism." Joseph Schumpeter

"People who don't take risks generally make about two big mistakes a year. People who do take risks generally make about two big mistakes a year." **Peter Drucker**

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTH	3.89%	-1.58%	5.47%
ROLLING 1 YEAR	13.37%	14.09%	-0.72%
ROLLING 3 YEAR	13.37%	6.63%	6.74%
ROLLING 5 YEAR	19.52%	11.81%	7.71%
ROLLING 7 YEAR	17.97%	8.94%	9.03%
ROLLING 10 YEAR	10.24%	3.61%	6.63%
SINCE INCEPTION*	17.02%	8.45%	8.57%
SINCE INCEPTION^	671.34%	187.17%	484.17%

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



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

JUNE 2017

Market and Portfolio Performance

The ASX200 Accumulation Index fell during the quarter (-1.6%) reflecting domestic issues relating to the banks, and weakness across the retail sector as consumer spending slowed and concerns emerged about the entry of Amazon into Australia. In addition, commodity prices also trended lower.

After the Brexit vote in the UK last year and the US elections that followed, global investors started to price a more favourable economic environment globally. More recently, some of this optimism has faded following elections in the UK and challenges the Trump government has faced passing legislation in the US.

In Australia, weakness in several discretionary retailers points to softness in consumer demand in the face of record levels of household debt and weak wages growth.

During the quarter, Australian banks faced increased scrutiny from regulators trying to influence lending behaviour and the recent significant upward trend in house prices. In addition, both Federal and State (SA) governments took the opportunity to announce new taxes to Australia's 5 largest banks, reminiscent of previous government's attempts to tax the resources sector.

These events are a reminder that companies do not operate in a vacuum and despite our best efforts at managing risk in the portfolio, companies can be impacted by "left-field" events. While these risks are part and parcel of investing in equity markets, we remain vigilant to particular concentrations in the portfolio, such as sensitivity to property prices or changes in interest rates.

In our view the best defence against risk is to focus on our VoF process, i.e. investing in companies with identifiable value latencies, with improving operating trends and managed by highly focused management teams. In addition, we also think diversification is an important factor that can add resilience at the portfolio level.

In the past, we have tried to tell you as much as possible about how we are implementing our VoF process on an ongoing basis. This quarter, we have detailed how we are adding diversification at the portfolio level.

During the quarter, relative portfolio performance was good (5.5%).

Key contributions to portfolio performance during the 3-month period include **Sims (SGM)** (improving outlook for earnings), **Boral (BLD)** (continued recovery in US housing, solid performance of Headwaters), and **Brinks (BCO)** (improving outlook for company turnaround).

Portfolio stocks that performed poorly during the quarter included **Regis (REG)** (regulatory pressures, negative sentiment towards sector), **Washington Soul Pattinson (SOL)** (underperformance of portfolio investments), and **Eureka Group** (recent concerns relating to operating performance, acquisitions and non-core investments).

During the quarter, we participated in the equity raising of **Bega (BGA).** Proceeds will be used to repay debt following the very recent acquisition of Vegemite and related products from Mondelez. Post raise, Bega's balance sheet will once again be "under-geared" relative to both dairy peers like Fonterra and Murray Goulburn and international brand companies like Kraft Heinz and Mondelez. This positions the company to build on both its dairy business and its relatively newer branded goods business should opportunities arise.

JUNE 2017

The portfolio initiated a small position in the IPO of **Elmo (ELO)** an HR software platform business. The software supports HR staff with recruitment, on-boarding, training (a particular strength of the software), and ongoing performance management. We were attracted to Elmo because of its expertise in HR, and its focus on the mid-market (100-1000 employees). The mid-market is less exposed to competition from large global players while avoiding the highly commoditised small end of the market.

Elmo's software provides several benefits to its clients. Firstly, it helps clients realise efficiencies by avoiding the need to hire additional HR staff as their business grows. The software can also aid HR's capabilities such as being able to more easily compare staff performance on multiple metrics. Finally, the software provides an electronic record for risk mitigation, particularly around training for compliance purposes e.g. OH&S.

Elmo's software is based in the "cloud", that means clients access Elmo remotely via the web rather than on premise, which is good for clients as the software is constantly updated. The cloud model is also attractive for Elmo as clients pay on an ongoing basis (in advance), at a very reasonable $30/employee/module/per year.

Elmo fits into our "platforms/digitisation" cluster. One of the key attractions of platform companies is they exhibit significant operating leverage as they grow. Each additional customer Elmo adds to its platform is highly profitable as the incremental costs are limited to the costs of account servicing and maintenance.

Our view is that Elmo's growth prospects are attractive. HR software is under-penetrated in Australia, with less than 10% of businesses currently using software (most use paper-based processes or other tools like Excel). A significant portion of the funds raised in the IPO will be spent on additional marketing to help drive sales. The remaining funds will be reinvested into the software to add new modules that Elmo can eventually sell to its existing client base.

Elmo's founders have built the business over the past 15 years from the bottom-up including all the technology. The founders and senior management team remain highly motivated to grow the business over the longer-term. We see significant value latency from Elmo penetrating the local market and adding product modules to its platform.

Finally, the Fund initiated a position in **TPI Enterprises (TPE)** following a capital raising that was undertaken by the group to pay down debt and fund working capital requirements.

TPE is a producer of licit Narcotic Raw Material ("NRM"), processed from farmed poppy plants and is the key input to many opiate-based medicines sold globally such as codeine and morphine.

In recent years, opiates have become particularly controversial in the US following an elevated number of opiate-related deaths and increasing levels of opiate addiction. The DEA (Drug Enforcement Agency) in the US recently reduced import quotas of certain types of opiates, which resulted in global oversupply of NRM and reduced capacity utilisation. Since then, two large global pharmaceutical companies, Johnson & Johnson and GlaxoSmithKline, sold their NRM operations in Australia (albeit they retained their end dosage products like Tylenol and Panadol).

Australia is a significant producer of NRM (30-40% of global supply), mostly out of Tasmania. More recently, TPE moved to diversify its supply of poppies after the removal of both import bans and the moratorium on mainland farming.

TPE recently signed a contract with a large European pharmaceutical company to ship poppies to Australia for processing at TPE's operations in Victoria. Given the added costs of shipping between

Europe and Australia this contract suggests that TPE can process NRM at a relatively low cost. In a commoditised market, this positions the company well to grow market share over the next few years.

The company has also made some initial strides up the value chain to become a producer of the “active pharmaceutical ingredient” (API) codeine phosphate (a more refined form of opiate) via both a toll processing agreement in the UK and the purchase of an API plant in Portugal. The UK market for API is closed (must be produced locally) and is dominated by API manufacturer McFarlan Smith (from where TPE has poached many of its European staff). TPE recently signed a contract to produce around 10% of the codeine phosphate for the UK in conjunction with Sterling Pharma in the UK.

The stock has performed poorly post its IPO (2 years ago), having missed a number of its early targets for sales and processing volumes. However, we are confident that both management and the board remain focused on successfully implementing the group’s strategy, which is now much closer to fruition.

The Portfolio – Strategy, Structure and Process

Strategy

- The strategy targets long-term capital growth and tends to outperform in down-markets.
- The strategy is suitable for investors with an endowment or family office mindset.
- The strategy is an unconstrained application of Cooper Investor’s VoF process in that it has no institutional constraints and is completely benchmark unaware.
- Because the portfolio is significantly different to the benchmark it can, at times, materially underperform relative to the benchmark.

Structure

- Concentrated, long-only, long-term equities fund (20-40 stocks)
- Portfolio of companies with value latencies, across 6 subsets of value, focused around several key “clusters”
- Long-term investments in “proprietorship managers” with enduring and unique cultures that display the following characteristics:
    - Humility, focused
    - Aligned interest
    - Deep, nuanced knowledge of business/industry
    - Counter-cyclical and value-based capital allocation

The portfolio remains positioned around six subsets of value:

- **Stalwarts** (10% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (ASX, Freightways)
- **Bond like equities** (5%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. (ALE Property Group, Viva REIT)
- **Growth companies** (42%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Lifestyle Communities, iSelect)
- **Asset plays** (10%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Washington Soul Pattinson, Remgro)
- **Low Risk Turnarounds** (16%) – sound businesses with good management in place and good balance sheets. We especially like spin offs and government to private turnarounds. (Clydesdale, Sims Metal)
- **Cyclicals** (9%) – stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. (Boral, Iluka)

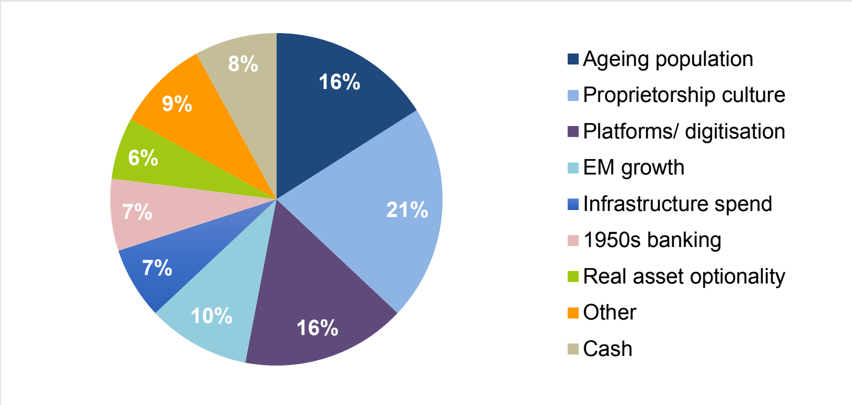
JUNE 2017

Currently the portfolio holds around 8% cash. The portfolio has around 13% of its assets invested in overseas stocks that own businesses in Switzerland, South Africa, USA, Canada, UK and Mexico.

Portfolio attributes as at June 2017 are summarized below:

P/E	17.4
Beta	0.78
Yield	3.0
P/Book	2.0
ROE	11.6
Tracking error vs. ASX 200	5.7
Stock Number	37

Below is a summary of 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 a summary of the "O" (operating, industry and strategic trends) in our VoF investment process. Clusters help us "fish in the most attractive ponds".

With recent additions, the portfolio is now more than 50% weighted to three core clusters, including the ageing population (eg Ryman, Lifestyle Villages, Regis), proprietorship cultures (e.g. Washington H Soul Pattinson, Reece, Bega), and platforms/ digitisation (Iress, Constellation Software, iSelect, Aconex, Steadfast).

Recently some of these clusters have faced challenges. For example, the ageing population cluster continues to see the impact of regulatory pressure on funding of aged care in Australia (Regis). Players face the challenge of managing rising costs and occupancy (EGH). In addition, there is both the challenge and opportunity of delivering growth via new developments (Ryman, Lifestyle Communities).

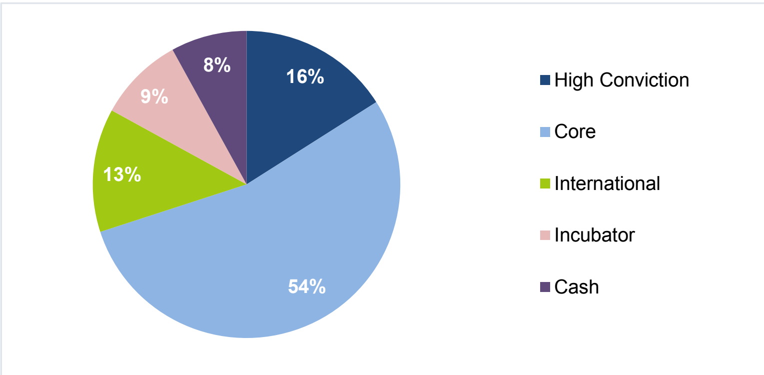
Process - VoF

- Repetitious implementation of the VoF process utilising CI's market access and networks
- Take advantage of liquidity events and market /stock dislocations
- Active positions yet more diversified than the benchmark (size, geography, cluster, value subset). Risk controlled for liquidity and conviction
- Small team leveraging CI's well-resourced research platform and back office strength

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

JUNE 2017

Below we have split the portfolio according to our own levels of confidence:



The position weightings are managed according to both our conviction levels as well as other overlays such as liquidity and risk.

The High Conviction category includes stocks where we have increased levels of confidence in the stock's value latency and in management's ability to execute. These stocks will have a higher weighting within the portfolio. The Core category includes portfolio stocks that are generally long-term holds.

International stocks are added by leveraging Cooper Investor's global research platform. Finally, the Incubator category are stocks that require an "up or out" decision, and are generally our smallest weightings in the portfolio. The incubator category adds optionality to the portfolio where we can add to positions as conviction levels increase or make the decision to exit.

Portfolio Risk

As Warren Buffett put it, "risk comes from not knowing what you are doing". Our focus in managing risk in the portfolio is bottom-up or stock by stock, via CI's VoF process.

However, top-down metrics of risk can also be useful. One commonly employed in the industry is portfolio volatility, which measures how much the value of the portfolio changes from week to week.

When we calculate the volatility of the Brunswick Fund it is substantially lower than the indexes:

	# Stocks	**Portfolio Volatility**
Brunswick Fund	37	8.7%
ASX50	50	14.3%
ASX200	200	13.8%
MSCI World	2492	12.0%

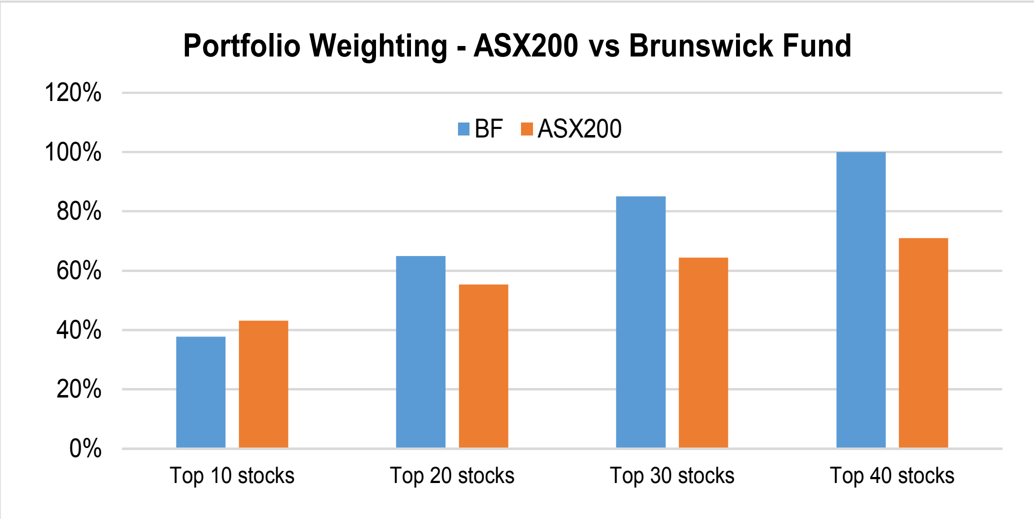
This might seem counter intuitive given the portfolio is invested in small and medium-sized companies that tend to be more volatile than larger companies. It also has a smaller number of stocks in its portfolio relative to the indexes.

JUNE 2017

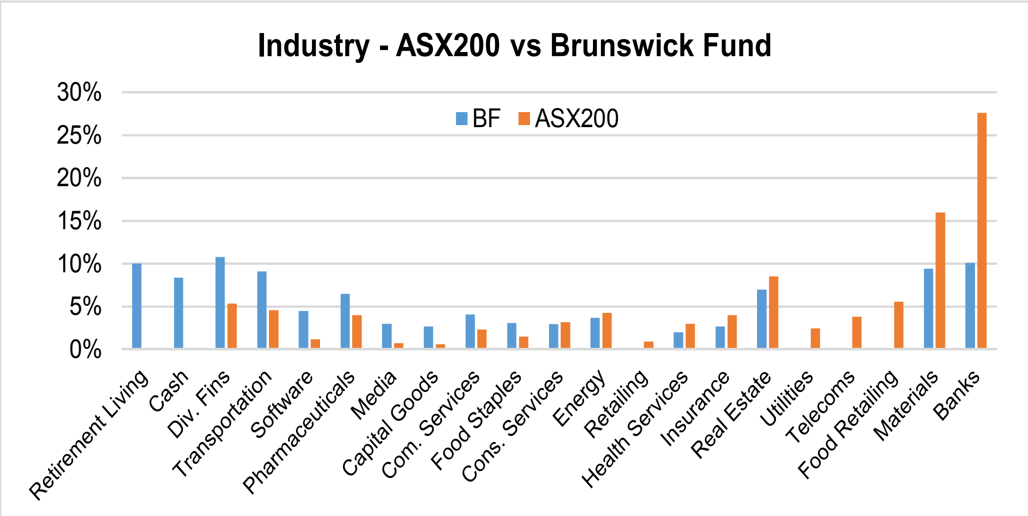
So how have we achieved this lower volatility?

The portfolio stocks are less correlated to one another, i.e. they are less likely to move in the same direction than index stocks (for a more detailed description of the portfolio's stock correlations vs the index see the Appendix). This results in the portfolio being more diverse than the indexes.

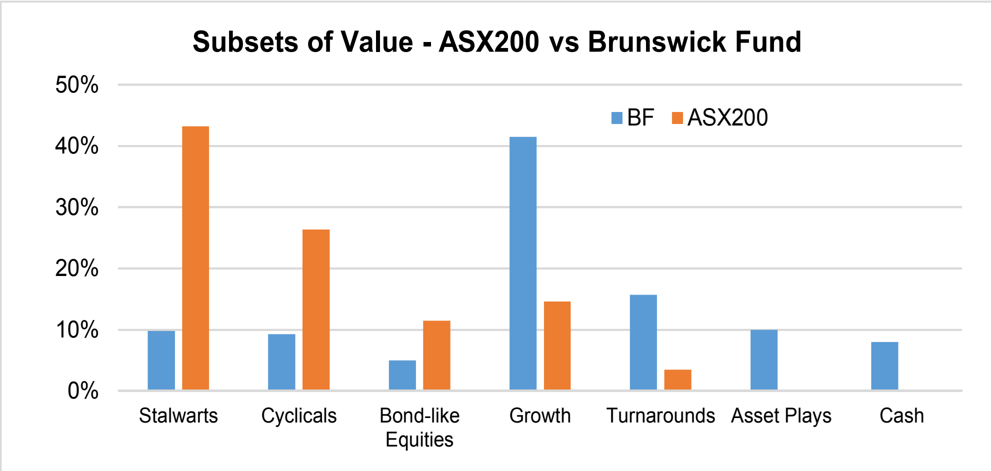
A key observation is that diversification within the ASX200 is impacted by its heavy weighting to the top 10 companies (~43%):



These 10 companies are mostly in the banking and materials sectors. In contrast, the Brunswick Fund is more diversified by Sector:



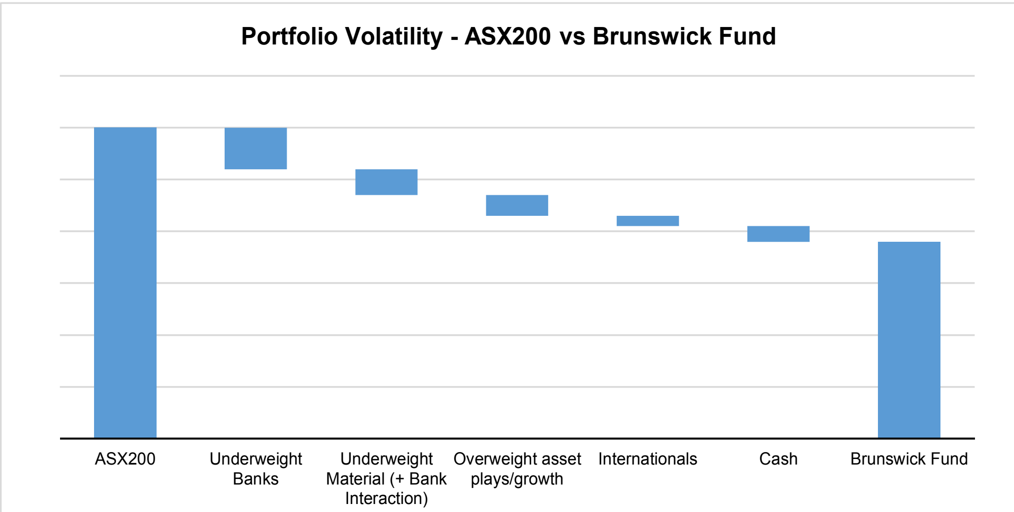
And the portfolio has greater exposure to asset plays and growth companies (subsets of value):



These subsets of value tend to be much less correlated to other stocks than the stalwart (banks) and cyclical (materials) categories.

Finally, the Brunswick Fund's holding in International stocks also adds to diversification.

While somewhat simplistic, the chart below is an illustration of the key reasons for the Brunswick Funds' lower volatility vs the ASX200:



Importantly, our view is that the superior diversification of the Brunswick Fund is one reason the portfolio has historically performed better than the ASX 200 in down-markets (~85% of the time).

In essence at least half of the ASX200 by value is heavily exposed to a few key issues e.g. house prices, interest rates, iron ore prices). In contrast, the variety of factors impacting the share prices of portfolio stocks is more diverse. We continue to think this is a sensible strategy in a world where regulatory and political risks remain high.

JUNE 2017

Industry Observations

Trip Notes

As usual, we undertook several trips both domestic and offshore. In particular, Perth remains of interest. We visited several companies in the mining services sector:

- Mining services is more buoyant now vs 12 months ago.
- A key driver of the improvement is a pick-up in work from the gold sector.
- Gold prices have been high and stable for a couple of years, helping fund several projects for the junior/mid-tier miners.
- Most of the smaller gold miners are heavy users of contractors.
- We visited an unlisted equipment rental and maintenance group that has seen a 35% increase in utilisation hours since November last year. They were also very bullish on the outlook for maintenance. Operators are running their existing equipment for longer to avoid capex which is increasing the market for maintenance contracts.
- One contractor commented that they had 60 investor meetings in CY16. So far in CY17 they've had 130.
- In general, balance sheets are much sounder across the services sector.

e also had several meetings relating to the Perth office market:

- Perth CBD vacancies appeared to have peaked late last year at 25%, falling slightly this year.
- This is not as bad as the early 90s when vacancies reached 30%.
- Incentives are still very high at 50%. The result is net rents in the CBD are now below 2007 levels (i.e. over 10 years they have gone backwards).
- West Perth vacancies continue to increase above 20% and are likely to increase further. This is concerning in light of CBD vacancies, i.e. that as leases expire in West Perth more businesses are likely to move to the CBD (we also think any bank exposure to these asset owners is concerning).
- Supply has added significantly to the problem; 2015 was the peak for office supply additions for the past 25yrs.
- More supply is coming as well (Woodside and Chevron buildings).
- Downsizing appears to have worked its way through now; there has been a modest uptick in enquiries.
- The biggest issue in the CBD is the "B" grade assets given vacancies are still high in "A" grade and premium.
- Asset sales have been minimal; institutional ownership of assets has increased significantly but private money has been looking around.

We also spent a week in Toronto with the main priority attending the **Constellation Software** annual general meeting and to sit down with management. Constellation is a company that has been in our Global Equities Funds for over 2 years and the Brunswick Fund for 1 year. Constellation, with an

US$11bn market cap, was founded by its CEO Mark Leonard nearly 25 years ago. Mark is the archetypal burning furnace – he is incredibly humble, avoids the limelight and is deeply driven and focused. He stays out of the media and investment community, and only meets with investors for half a day a quarter. His earning calls have no preamble and go straight to questions that usually last no more than 20 minutes.

Constellation is an amalgamation of many different vertical or industry specific software businesses. The company has been built up by acquiring small software companies (those with ~US$10m of revenues) and knowing how to run businesses of this size. Because Constellation isn't a self-promoter we believe the market doesn't understand and appreciate either the quality of these small businesses or the strong cultural aspects that lie throughout the organisation.

The company will be generating ~US$500m of free cash flow and Mark wants to deploy as much of this as possible into high returning acquisitions. The company is certain that it won't lower its return hurdles to deploy all the capital it can – we see a war chest of more than US$1.5bn between the balance sheet latency and annual cash generation. While we don't expect the company to deploy those sums our main takeaway is that the company can keep doing north of US$200m per annum of small deals for the foreseeable future and use M&A to drive double digit contributions to the top line. This is incremental to the underlying business that is consistently growing 3-5% per annum, driven by a steady stream of recurring maintenance revenues. More so if the company can't deploy all its capital into acquisitions the cash remaining will eventually be returned to shareholders.

Appendix – Portfolio Volatility Comparison to Indexes

One portfolio risk metric that is used widely is volatility (higher volatility = more risk), having its foundation in modern portfolio theory (despite the theory's many flaws).

As a quick recap of the theory, it was demonstrated (by Markowitz and others) that portfolio volatility (technically volatility squared for the mathematically minded) is the sum of two factors:

1. Individual stock volatilities, summed according to their fund weighting;
2. Covariance, which is the way that individual volatilities interact. Essentially, there is an offset to portfolio volatility from diversity – i.e. when one stock goes down, others go up. This can be measured historically according to the degree of correlation of the stocks.

Interestingly, the second factor is far more important.

For example, a portfolio with four uncorrelated stocks will usually have a lower volatility than a portfolio consisting of the big four banks, even if the four stocks are individually more volatile than the banks.

The table below shows the volatility and correlation of the portfolio in comparison to the ASX50, ASX200 and the MSCI World. We use weekly returns over the past three years.

Not surprisingly, the more concentrated index (ASX50) has a higher portfolio volatility than the more diversified MSCI World. Of most interest to us though, the Brunswick Fund shows substantially lower portfolio volatility, even compared with the MSCI World:

	# Stocks	Portfolio Volatility	Ave. Stock Vol	Ave. Correlation	Stock variance	Portfolio Covariance
Brunswick Fund	37	8.7%	29%	8%	0.2%	0.6%
ASX50	50	14.3%	24%	29%	0.2%	1.8%
ASX200	200	13.8%	31%	19%	0.2%	1.8%
MSCI World	2492	12.0%	29%	17%	0.01%	1.4%

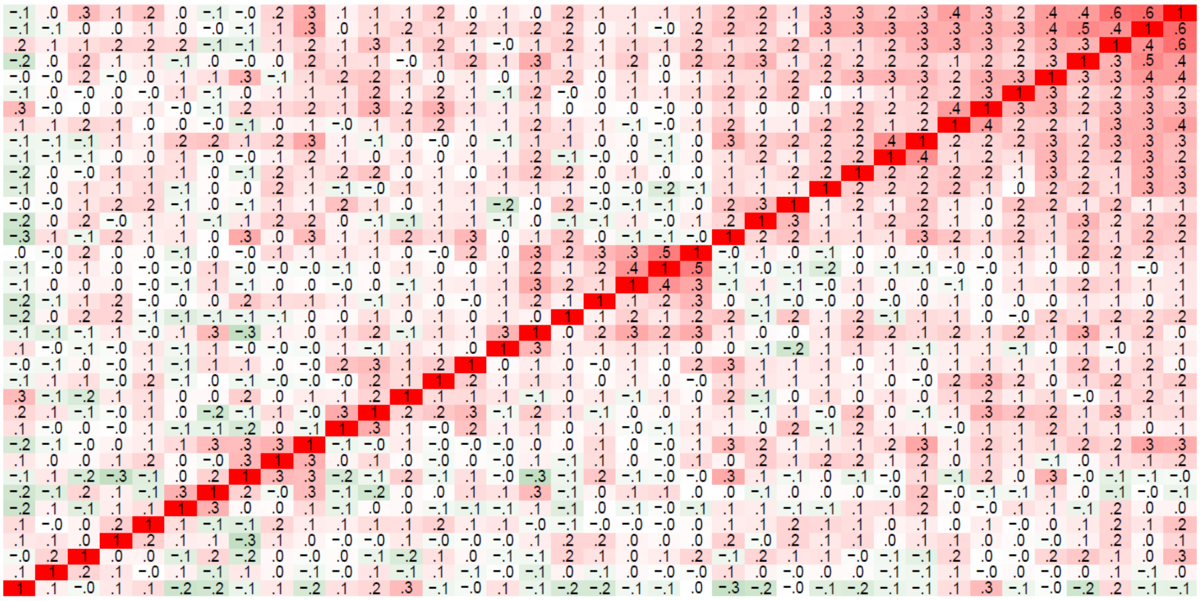
Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

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

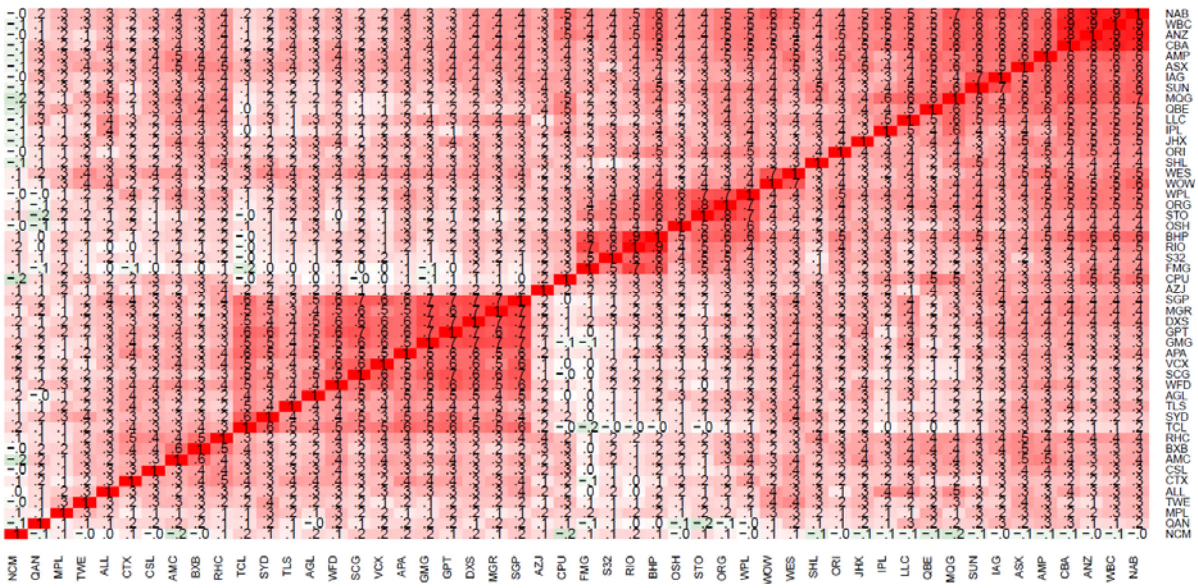
JUNE 2017

As we've highlighted in the table, the key reason for the Brunswick Fund's lower portfolio volatility is its lower correlations and hence lower covariance.

We can illustrate these lower correlations better in pictures. Below is a 'heat map' of the Brunswick Fund. The 'redness' illustrates how correlated stocks are to one another:



This compares to the heat map of the ASX50 below (ideally we would show the ASX200, but this would make the heatmap too large to show. We expect it would be less red outside the top 50):



This difference in "redness" is one indicator of the Brunswick Fund's diversification.

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

JUNE 2017

While we didn't set out with a low portfolio volatility target in mind, we have tried to achieve diversification across a range of factors including sector, size (market capitalisation), region, cluster and value subset, while still remaining focused on finding stocks with significant value latency according to our VoF process.

Some caution is warranted with the above analysis. In particular, the calculated correlations are based on history, whereas experience tells us that correlations change over time and tend to increase (across the board) in challenging markets.