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.

SEPTEMBER 2016

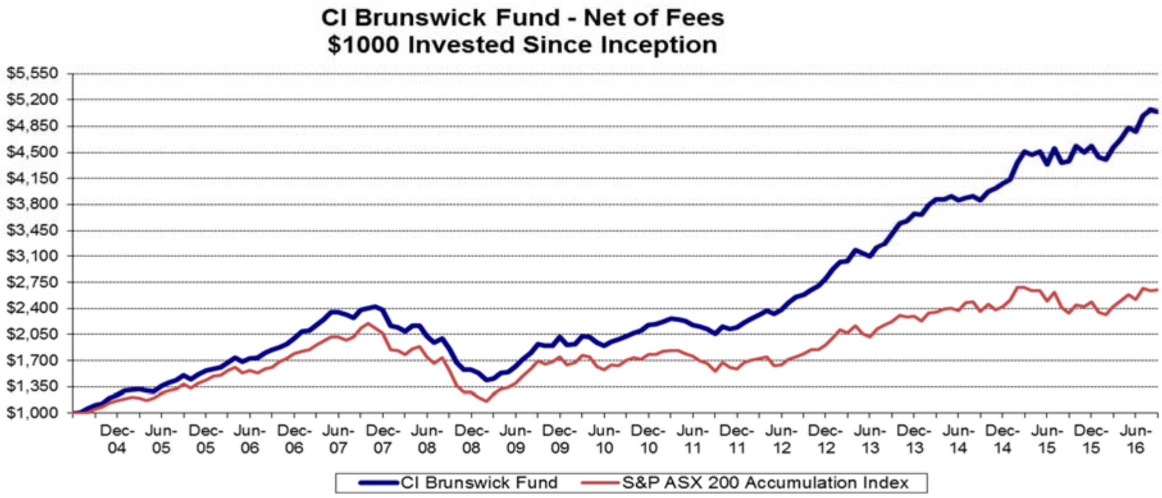
"Men, it will not be long until there will be a mob assembling here to hang Senators from the rafters of the Senate. I have to determine whether I will stay and be hung with you, or go out and lead the mob" - Huey Pierce Long Jr., nicknamed The Kingfish, was an American politician who served as the 40th Governor of Louisiana from 1928 to 1932 and as a member of the United States Senate from 1932 until his assassination in 1935. A Democrat, he was an outspoken populist who denounced the rich and the banks, and called for "Share our Wealth."

"A society that puts equality before freedom will get neither. A society that puts freedom before equality will get a high degree of both." Milton Friedman.

"The Great Depression, like most other periods of severe unemployment, was produced by government mismanagement rather than by any inherent instability of the private economy." Milton Friedman.

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	5.90%	5.14%	0.76%
ROLLING 1 YEAR	16.69%	13.17%	3.52%
ROLLING 3 YEAR	16.17%	5.99%	10.18%
ROLLING 5 YEAR	21.66%	11.18%	10.48%
ROLLING 7 YEAR	16.83%	6.59%	10.24%
ROLLING 10 YEAR	12.81%	5.09%	7.72%
SINCE INCEPTION*	17.49%	8.27%	9.22%
SINCE INCEPTION^	620.51%	164.65%	455.86%

* 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 performed strongly in the September quarter (+5%). This included a post Brexit recovery during the month of July followed by a small downward drift during August as investors digested a mixed set of company results.

Key contributions to portfolio performance during the quarter included **iSelect (ISU)** (good 2H 16 result with strong growth in new product verticals), **Lifestyle Communities (LIC)** (solid FY16 result), **Equity Trustees (EQT)** (new management and refocus of business), and **Summerset (SUM)** (strong 1H 16 result).

Portfolio stocks that performed poorly were **TPG Telecom (TPM)** (weaker than expected FY17 guidance driven by slower organic growth, increasing margin pressure from the NBN, and delays in realising IIN synergies), **Washington Soul Pattison (SOL)** (derating of TPM, its largest portfolio holding), **Remgro (REM)** (partly currency related, news of a rights issue) and **Carindale Property Trust** (**CDP**) (concerns that US bond rates will rise).

During the quarter the Reserve Bank of Australia lowered rates (again) by 25bps, bringing the cash rate down to 1.5%. The key reasons cited were:

- conditions have become more difficult for a number of emerging market economies and the underlying pace of China's growth appears to be moderating;
- Australia's terms of trade remain much lower than it has been in recent years;
- recent data suggests that overall growth is continuing at a moderate pace, despite a very large decline in business investment;
- other areas of domestic demand, as well as exports, have been expanding at a pace at or above trend;
- labour market indicators continue to be somewhat mixed, but are consistent with a modest pace of expansion in employment in the near term;
- inflation remains quite low;
- the most recent information suggests that dwelling prices have been rising only moderately over the course of this year, with considerable supply of apartments scheduled to come on stream over the next couple of years, particularly in the eastern capital cities;
- growth in lending for housing purposes has slowed a little this year. This suggests that the likelihood of lower interest rates exacerbating risks in the housing market has diminished.

In contrast, the US Federal Reserve continued to signal that an increase in rates is now more likely. In August, Fed Chair Janet Yellen stated that *"…in light of the continued solid performance of the labor market and our outlook for economic activity and inflation, I believe the case for an increase in the federal funds rate has strengthened in recent months".*

As we have previously spoken about, the collective action of Central Banks across the globe is unprecedented. For example, the Bank of England's current cash rate (0.25%) is lower than it has ever been over its 300-year history:

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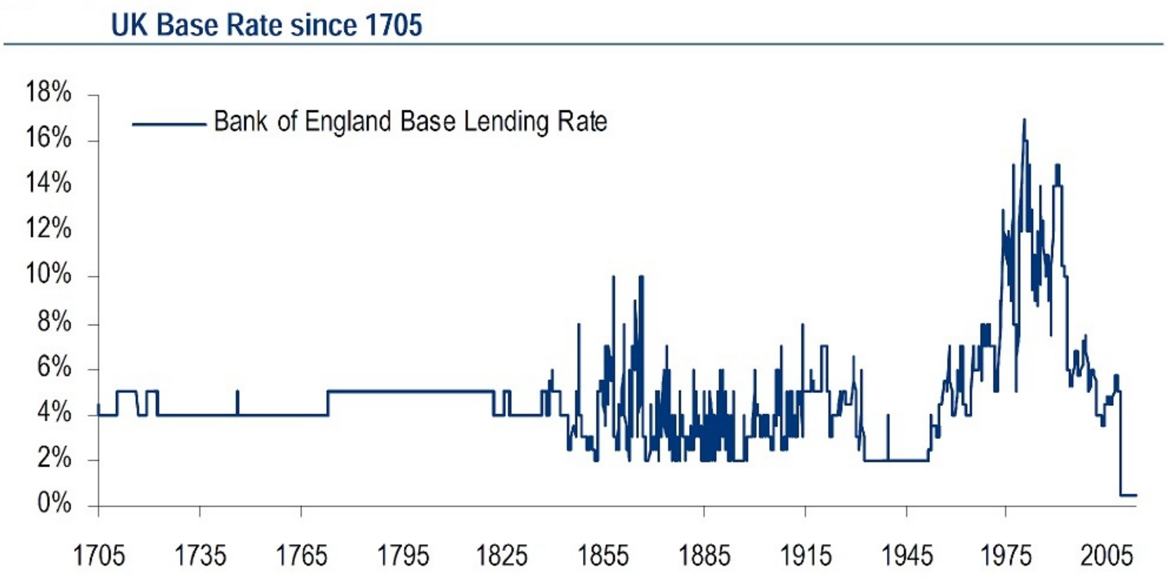

(Source: Bank of England)

The ECB, BoE and BoJ have extended their asset purchase programs (quantitative easing) to include corporate debt and equities, in what can only be described as a large, unprecedented experiment.

Although we are bottom-up investors, the magnitude of this intervention by governments in financial markets is hard to ignore and has undoubtedly influenced asset prices and skewed the allocation of capital across economies. There is little doubt of the potential future risks to asset prices and performance of the portfolio, even though the end game remains uncertain.

We remain entirely focused on implementing our investment philosophy. Perhaps the most important part of this is finding and backing the best management teams, who will ultimately find a way to navigate whatever is ahead of us. These “best in breed” managers are often owner operators with a proprietorship culture, deep (nuanced) industry/ business knowledge, are passionate and above all honest.

We also believe that a number of secular growth opportunities will remain robust in almost any future scenarios and so we continue to focus our efforts around “clusters” of companies exposed to these trends. For example, the ongoing dynamic of our ageing population.
In addition, the portfolio remains well diversified across sectors, particularly relative to the ASX200 Accumulation Index which is much more concentrated in Banks and Resource companies (~40% combined).

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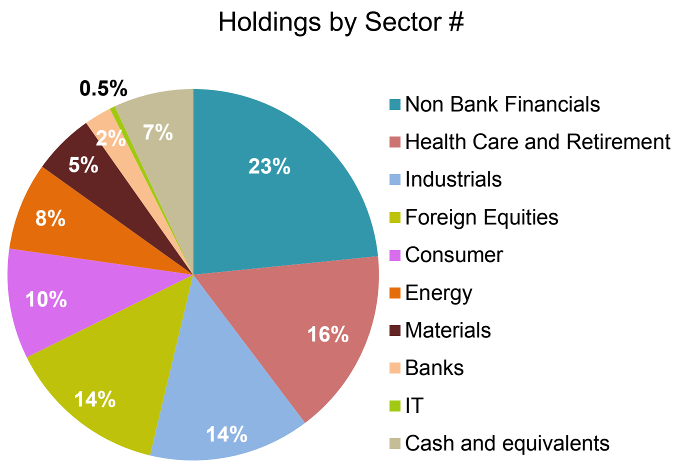
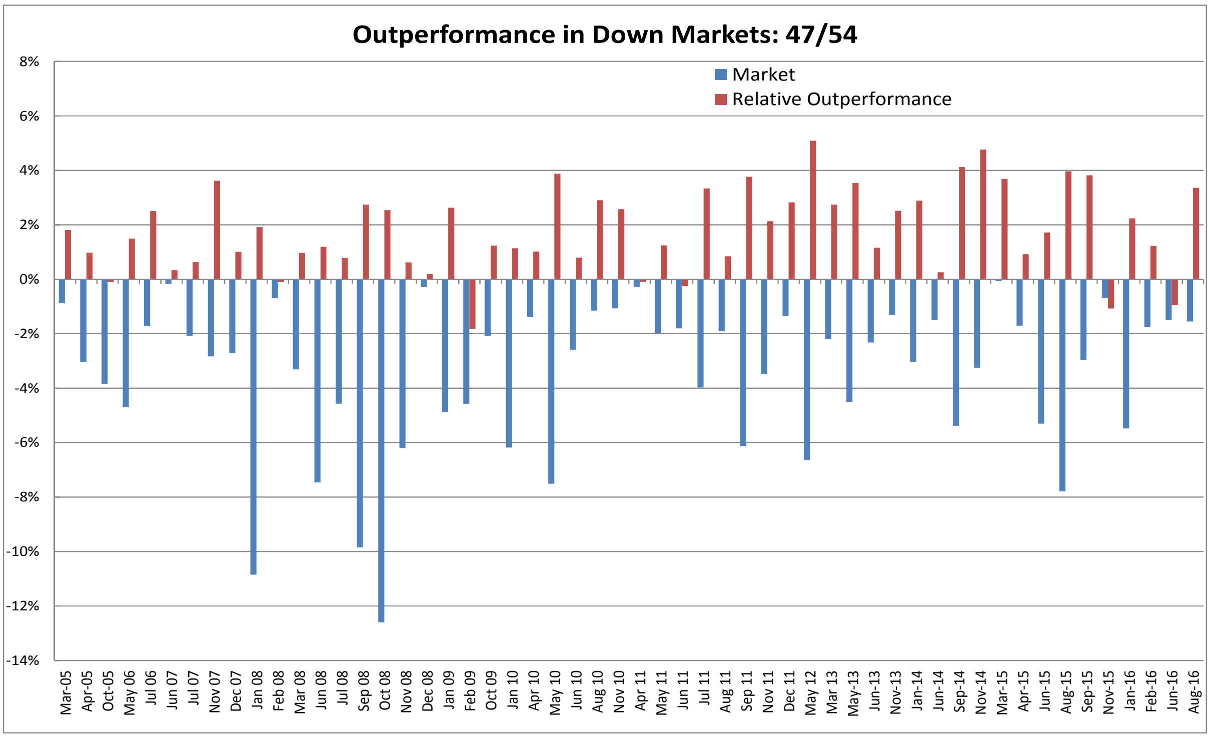


#numbers are approximate / may be rounded, CI internal sector definitions.

The portfolio is also more diversified by market capitalisation, geography and by CI's subsets of value definitions. Combined, we believe this is a key reason for the portfolio's 87% hit rate of out-performance in down markets:



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The Portfolio

The portfolio remains positioned around six subsets of value:

- **Stalwarts** (19% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (Wesfarmers)
- **Bond like equities** (12%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. (ALE Property Group, Auckland Airport)
- **Growth companies** (36%) – 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. (Jardine Strategic, Soul Pattison, Remgro)
- **Low risk turnarounds** (11%) – 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** (3%) – 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 7% 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 September 2016 are summarized below:

P/E	18.1
Beta	0.77
Yield	3.0
P/Book	1.9
ROE	10.5
Tracking error vs. ASX 200	5.2
Stock Number	39

During the September quarter we added a couple of new stocks to the portfolio.

Following a large derating in its share price, we were able to purchase a stake in **Regis Healthcare (REG**) at what we believed was an attractive price. This followed a number of negative announcements relating to the government's funding for the sector ("ACFI" or Aged Care Funding Instrument).

Regis is the "Gold Standard" in the listed Aged Care sector with the highest quality portfolio, systems and governance and a long track record of performance (est 1993). Our view is the sector's structural growth opportunity remains strong due to the ageing demographic and a highly fragmented market that is likely to consolidate. Regis is the 3rd largest operator but only has 2.5% market share. Greenfield / brownfield developments typically deliver attractive returns which can be self-funded by accommodation bonds. This allows the business to expand without needing to raise new equity. However, 70% of income comes from the Government, which is a risk to earnings should growth exceed the Government's 5% pa funding growth target.

We also took the opportunity to participate in the IPO of **Viva REIT (VVR).** The stock has very simple and secure cash flows underpinned by a 15.3 year weighted average lease expiry, fixed 3% per annum rental increases, and a triple net lease structure. The property portfolio has been established over a period of more than 100 years and would be very hard to replicate given the scale and strategic locations of properties. Viva Energy has an acquisition pipeline of 100 sites over the next five years, some of which may be added to the property portfolio and therefore increase the distribution profile. We think the Viva Energy REIT can deliver a 10% p.a. total return comprising a 6% dividend yield and 4% earnings growth. There is upside to this if the dividend yield compresses towards the level of peers such as ALE Property Group and BWP Trust which trade on dividend yields of 4.5% to 5.5%.

During the quarter **Ryman Healthcare (RYM)** purchased an 8.9Ha site in Mt Eliza where its research showed there was a shortage of retirement living options in both Mt Eliza and the broader Mornington Peninsula area. This will be Ryman's fourth site in Victoria and puts them on track to have five opened villages in Victoria by 2020. We note that Ryman considers Victoria alone is a bigger opportunity than all of New Zealand.

Industry Observations

General Industry Observations

- We are still in the early stages of companies migrating to the "Cloud". While the economics of the public cloud for start-up companies appears strong, driven by the more efficient utilisation of computing equipment by scale players such as Amazon's cloud business AWS, the debate is more complex for established businesses;
- Microsoft's spend on their cloud product Azure is now 5x Amazon's spend on AWS;
- The cost of the NBN will be borne either by consumers or Retail broadband providers, or a combination of the two;
- Companies are increasingly hiring internal teams to develop data smarts or mining. As the amount of stored data grows this will become both increasingly sophisticated and a source of competitive advantage;
- The value of some drilling rigs has doubled in recent months, albeit still at a value well below book;
- Within the wealth management sector, growth in FUM flow is increasingly being captured by separately managed account (SMA) platforms;
- There is still a significant gap in installed capacity required to meet the renewable energy target (RET) as it stands;
- The pipeline of Solar projects suggests that the economics of Solar is much improved at the "farm" level, arguably now much closer to Wind;
- Regulation has negatively affected Hospitals, Pathology, Radiology and Primary Care at various points over the past 20 years. This proved transitory, either because operators eventually more than offset the changes (eg via increased scale) or, where the final impact of regulation proved less significant than originally anticipated;
- The mortgage broker channel is rapidly approaching 60% of all mortgage sales in Australia up from 30% in recent years. A remarkable change that puts increasing power in the hands of brokers. One implication is that the branch network's primary role is now serving rather than acquiring customers. It also means Banks are increasingly focused on product manufacturing.

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Tourism Industry Observations

The tourism market continues to look attractive over the next five years:

- $3 trillion is being invested globally in tourism infrastructure/assets;
- There are currently 100m Chinese outbound tourists. This is expected to grow to 200m by 2025. Australia gets 1% of Chinese tourists, however Australia is no.1 destination in terms of aspiration. Australia expects to get 5m Asian tourists per year by 2025;
- The Australian tourism industry has a labour shortage of 35k people. This will increase to 125k by 2020;
- In terms of Hotel rates (RevPAR), there has been very good growth in the tourist areas of QLD, Sydney and Hobart. However, Darwin, Perth, Brisbane and Adelaide are all struggling and impacted by mining;
- Hotel Rates in Mooranbah, QLD peaked at $250/night and 80% occupancy, but are now only 10% occupied at $50/ night.

Technology continues to be a key driver of industry dynamics:

- Airbnb now has 15k rooms in Sydney (relative to 24k Hotel rooms in Sydney), generating $190m of revenues at an average of $196/night. With 17% occupancy it represents about 6% of the accommodation market in Australia and overseas. Airbnb is mostly eating into the 3-4 star market. 1 in 5 residences in Bondi are on Airbnb;
- Airbnb may not necessarily compete with Melbourne/Sydney CBD, but as a legitimate substitute product it provides some cap to pricing;
- Airbnb has been operating for only 9 years and just 4 years internationally – as has Uber. Uber now captures 50% of all corporate taxi travel in the US;
- AirBnb faces some regulatory headwinds with issues including a recent death occurring at a property in NSW and a lack of safety equipment (e.g. fire extinguishers).
- Tasmania is trying to restrict AirBnb premises to 42 days rental a year only (school holidays) and there have been other crack downs recently in San Francisco and Berlin;
- Online travel agency players Expedia and Priceline are the dominant channels to market for Hotels now and some Hotels have 60% of their sales via these two players.

Trip Notes

During the quarter we visited the UK to investigate how the economy and companies are faring post ‘Brexit’. While it is still too early to be definitive, the economy appears to be holding up better than expected and reassuringly the consumer has continued to spend. However, there remains a lot of uncertainty around the political and economic outlook, particularly surrounding the UK negotiating its exit from the European Union. Although this is providing a more challenging macroeconomic backdrop for companies operating in the UK, we think the economy will be supported by the lower Pound and monetary and fiscal support if needed. At this point we don’t see Brexit resulting in a hard landing for the UK economy, indeed it may prove to be a long-term positive although we expect ongoing volatility in the short-to-medium term.

While in the UK we also attended **Clydesdale Bank’s (CYB)** capital markets day. Presentations by operational management highlighted a clear and simple strategy, and served to reinforce our confidence in the depth and quality of the management team. Revised medium-term (FY19) targets included tempered mid-single digit revenue growth expectations, a cost-to-income ratio of 55%-58%, and a double digit return on tangible equity which encouragingly has been brought forward by one year. We think there is a level of conservatism in management’s medium term targets which is prudent given the more challenging operating environment discussed above.

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Interestingly, management noted that having successfully delivered FY16 results they would now consider acquisitions, of businesses or loan portfolios, if the right opportunity presented itself. This is a subtle change in messaging and something we will continue to monitor closely.

We also visited NZ during the quarter, in particular to touch base with portfolio companies. One of these visits was to the main depot of **Freightways (FRE)** in Penrose, Auckland. This is a central hub for their Express Parcel delivery business and the company's head office. Over time, the company has optimised both the layout and work flow of the site to improve its operating efficiency. However, it is yet to invest substantially in automation (unlike large global operators such as UPS). This is soon to change with an investment in Wellington as a trial, with the expectation this will deliver mainly revenue benefits (mostly due to correct charge for weight). We think there is scope for this to be rolled out at other sites should it be successful.

In addition, while Freightways already has a relatively new Information Management facility collocated at Penrose, their Australian sites are small, reducing the site efficiency relative to peers. This is also soon to change with an investment to consolidate their Sydney Information Management sites over the coming year. We expect that over time both of these investments will add to Freightway's margins and returns.

In NZ we also met with a number of other companies in banking, IT, media, agriculture and transport/logistics. More broadly our impression was that the NZ economy continues to track well, growing ahead of most other OECD countries.