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 2017

"It is a mistake to try to look too far ahead. The chain of destiny can only be grasped one link at a time." Winston Churchill

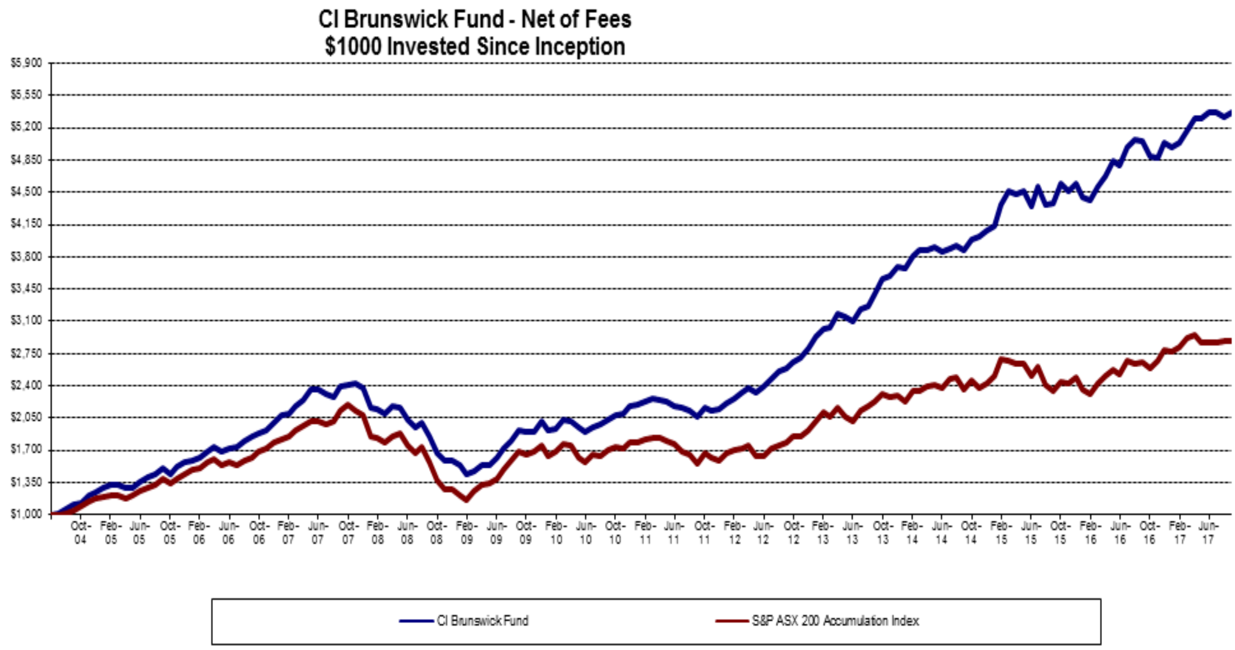
"A major boom in real stock prices in the U.S. after 'Black Tuesday' brought them halfway back to 1929 levels by 1930. This was followed by a second crash, another boom from 1932 to 1937, and a third crash. Speculative bubbles do not end like a short story, novel, or play. There is no final denouement that brings all the strands of a narrative into an impressive final conclusion. In the real world, we never know when the story is over" Robert Shiller

"Complacency is a continuous struggle that we all have to fight." Jack Nicklaus

"..my definition is a Stoic is someone who transforms fear into prudence, pain into transformation, mistakes into initiation, and desire into undertaking." ***Nassim Taleb***

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	0.43%	0.68%	-0.25%
ROLLING 1 YEAR	7.51%	9.25%	-1.74%
ROLLING 3 YEAR	13.38%	7.08%	6.30%
ROLLING 5 YEAR	17.61%	10.09%	7.52%
ROLLING 7 YEAR	16.89%	7.85%	9.04%
ROLLING 10 YEAR	10.11%	3.09%	7.02%
SINCE INCEPTION*	16.71%	8.34%	8.37%
SINCE INCEPTION^	674.63%	189.12%	485.51%

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



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Market and Portfolio Performance

The ASX200 Accumulation Index increased moderately in the September quarter +0.68%, with ongoing uncertainty in macroeconomic trends and a mixed set of results in the August reporting season.

On the one hand, there are various signals that are broadly supportive of equity markets. In particular, growth appears to be returning to both US and European markets and with early signs of inflation, central banks have taken the first steps to normalising the extremely supportive policies (lower interest rates and quantitative easing) that were put in place following the GFC.

On the other hand, from its absolute low point, the recovery in stock markets since the GFC, our last major correction, has been in many ways remarkable. The S&P500 has increased 310% (15% CAGR) and the ASX200 150% (10% CAGR). At the same time, market volatility (a measure of investor's risk appetite) remains at near record lows, despite what appears to be a myriad of geopolitical and economic risks, including high levels of debt in many countries (particularly Australia) and the still significant intervention of central governments.

Although more an odd coincidence in terms of dates, various economic commentators (for example Ann Rutledge of Forbes) have highlighted the significant share market corrections that occurred during or close to the month of October in each of 1987 (black Monday), 1997 (Asian Financial crisis) and 2007 (GFC) (not to mention 1929). The key point being it has been 10 years since the last big correction began. We therefore remain ever vigilant of companies:

- exposed to high levels of debt
- that have been beneficiaries of the "financialisation" of the global economy, which has underpinned growth in recent decades

It also suggests more broadly, a need to consider opportunities with:

- real or hard assets with low correlation to other asset classes:
    - Gold, and other commodities
    - Property, with latent options and long-term leases
    - Agricultural products and related goods
- core household goods and services
- businesses backed by high levels of cash
- companies that are proponents or beneficiaries of disruptive technologies (as post GFC many flourished when incumbent models came under both cyclical and structural pressure)

In addition, our focus remains on implementing the portfolio's strategy and CI's VoF process which has proven resilient through various market cycles.

During the September quarter, the Brunswick Fund's performance slightly lagged the index +0.43% absolute or -0.25% relative.

Key contributions to portfolio performance during the 3 month period include **Clydesdale Bank (CYB)** (positive Q3 trading update), **TPI Industries (TPE)** (acquisition of API manufacturer, new contract wins), **Brinks (BCO)** (improving outlook for turnaround) and **Bega (BGA)** (good FY17 result, improving opportunities in both dairy and branded foods).

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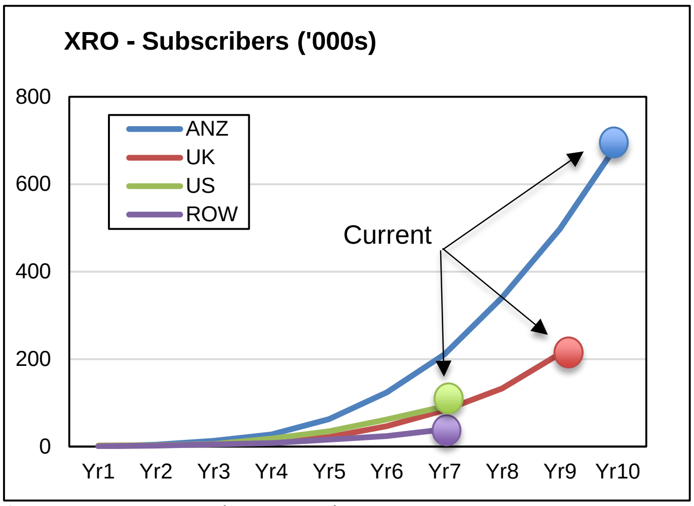
Portfolio stocks that performed poorly during the quarter include **iSelect (ISU)** (disappointing 2H trends in revenue), **Sims Metal Management (SGM)** (abrupt departure of CEO, deteriorating outlook for scrap metal prices), and **Aurizon (AZJ)** (ongoing turnaround challenge).

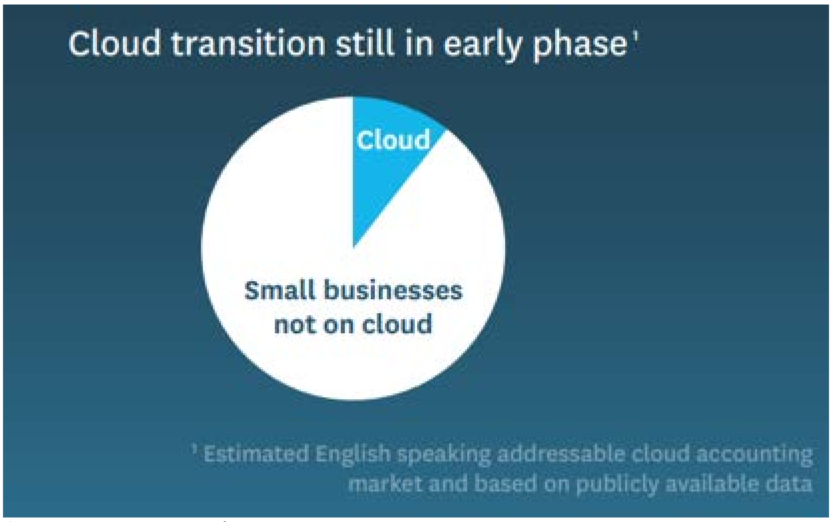
After watching the company for a number of years, we recently added New Zealand based **Xero (XRO)** to the portfolio**.** XRO is a provider of internet or cloud based accounting software to SME's globally. Accounting software has in the past been dominated by a few main players: the likes of SAP and Oracle servicing the big end of town, and Intuit (owner of Quickbooks) and Sage at the small end of town.

Over the past 10 years XRO has grown its base of subscribers to more than one million, mainly in Australia/NZ and the U.K:



Source: Xero presentations, annual reports

Underpinning XRO's growth is a broad movement of customers from desktop accounting software to cloud based software. In addition, XRO targets the so called 'whitespace', which is customers that have never previously used accounting software, instead using excel or other paper based tools. Globally, this transition to the cloud is still in its infancy:



Source: Xero presentation

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The use of accounting software is compelling for small business who can save time by digitising processes around expenses, invoicing and tax. A cloud based offering is even more compelling as the tool can be utilised just as easily in the office, in the field, when making purchases, or at home. XRO's software has been designed so it's simple to use and free of all the normal accounting jargon.

Interestingly, cloud penetration is highest in NZ, closely followed by Australia and is way ahead of the U.K. and the US. Undoubtedly XRO's local presence has been a factor, as perhaps has our willingness to utilise technology and the prevalence of 4G. The transition to the cloud has many years to play out and should underpin XRO's growth for years to come.

However, XRO does not operate in a vacuum. Incumbent desktop providers **Intuit (INTU**, US based), **Sage (SGE**, UK based) and **MYOB (MYO**, Australian based) have responded by developing their own cloud offerings (eg QBO, or QuickbooksOnline and SageOne), and competition remains fierce. So far XRO appears to be winning the race in ANZ where it's capturing 70% of all new subscribers in the cloud and in the UK where it's capturing around 50%. To date, though, XRO has struggled in the US making little impact in that market. Encouragingly, XRO recently changed strategy in the US to take a slower approach, with a focus on winning over accountants, rather than trying to go direct (Xero has successfully focused on accountants in all its other markets). XRO's big advantage remains that it is a pure play cloud business, unencumbered by legacy technology.

Over time we expect XRO will also find ways to extract value from its 'ecosystem' – a network of providers with add-on products and service such as payroll, HR, workflow, banking etc. XRO's data is very rich for banks, providing real time insights into small business cash flows that can be used to enhance lending decisions. Over time we also expect customers to become increasingly sticky leading to the many benefits of incumbency such as pricing power.

XRO's management team have all the qualities we look for in a company: focus, energy, deep nuanced knowledge and aligned interest (founder Rod Drury remains CEO and significant shareholder).

During the quarter the Fund also added **Arena REIT (ARF)**, via participation in an equity raising undertaken by ARF to fund the acquisition of new assets. ARF is a focused owner of property assets principally in the areas of early learning/childcare, healthcare and education (i.e. property focused on social services).

Despite concerns that supply of childcare centres has increased more recently, ARF remains focused on locations where supply/demand trends are attractive, in particular in lower socioeconomic areas that are likely to benefit from changes to the childcare rebate in July 2018.

Following its recent acquisitions, ARF's development profile provides an attractive source of growth in rental income over the next few years. This rental stream is underpinned by a relatively long average lease expiry or WALE (12.8yrs), triple net leases (leasee funds all operating costs including maintenance capex), with stable counterparties, and relatively low gearing.

In our view transactional rental yields (or passing yields) remain attractive in early learning versus other sectors, where yield compression has been much more significant, despite underlying trends (demand growth, policy support) which appear more favourable.

Our preference has been to invest in specialised property (eg **Viva REIT** focused on petrol stations and **ALE Property** focused on hospitality), as these businesses tend to better fit our VoF process (where we value focused management teams). Like all our portfolio stocks, we rate the management team of ARF highly given their focus and deep nuanced knowledge of the industry.

Domestically, the Fund also added **Adelaide Brighton (ABC)** to the portfolio. ABC provides a high quality exposure to the building materials sector with good prospects for earnings growth via both an expected improvement in industry pricing and a recovery in the South Australia market, which is ABC's most profitable market. ABC has a solid management team with a track record of being good custodians of capital as evidenced by a return on funds employed of almost 20%, which is much higher than peers. A strong balance sheet and reliable cash generation support ongoing capital management in the absence of acquisitions or significant growth capex. In the mean time we receive a 4% dividend yield (fully franked) that should continue to grow.

Finally, we also added US company **TE Connectivity ("TE")** to the portfolio (this was also a recent addition to CI's global equities portfolio). TE is a global leader in the manufacture of electronic connectivity and sensor products across a range of industries (automotive, industrial, aerospace etc). Since its spin-off from Tyco 10 years ago, TE's leadership team has made fair if not spectacular progress in repositioning the company into more attractive end markets. However, our interest in the stock as a "low risk turnaround" increased significantly in the last 12 months as a new management team was put in place who we believe can accelerate the self-improvement story and instil greater financial discipline. Our increased confidence came from CI global team's previous investment in peer Amphenol and in tracking the performance of new CFO Heath Mitts in his previous role at IDEX Corporation. In short, we see multiple opportunities to realise value via margin improvement, capex optimisation, M&A, and balance sheet latency, as well as the broader growth opportunity of increasing "electrification" of its end markets.

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 benchmark unaware.
- Because the Fund is significantly different to the Benchmark it can, at times, materially underperform relative to the benchmark.

Structure

- Concentrated, long-only, long-term equity fund (20-40 stocks)
- Portfolio of companies with value latencies, across 6 subsets of value, focused around a number of key "clusters"
- Long-term holds 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

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The portfolio remains positioned around six subsets of value:

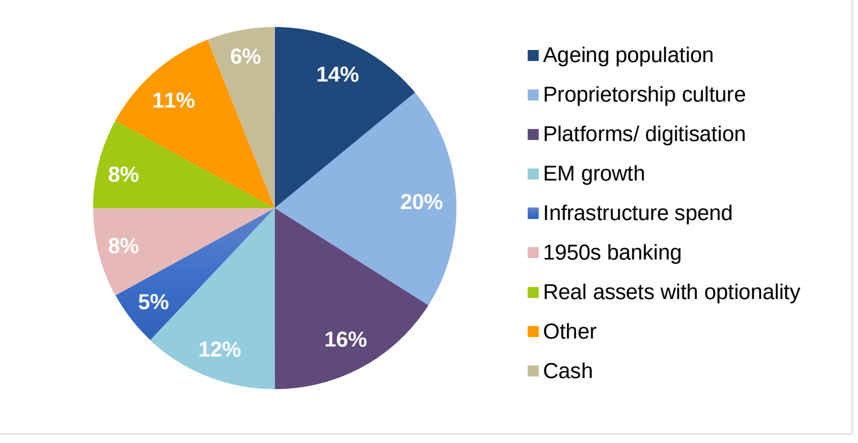
- **Stalwarts** (8% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (ASX, Freightways)
- **Bond like equities** (5%) – stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. (ALE Property Group, Arena REIT)
- **Growth companies** (42%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Lifestyle Communities, Xero)
- **Asset plays** (10%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Soul Pattison, 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** (13%) – stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. (Boral, Iluka)

Currently the portfolio holds around 6% cash. The portfolio has around 16% of assets invested in overseas stocks that own businesses in Switzerland, South Africa, USA, Canada, UK and Mexico.

Portfolio attributes as at September 2017 are summarized below:

P/E	18.1
Beta	0.78
Yield	2.9
P/Book	2.2
ROE	12.1
Tracking error vs. ASX 200	5.7
Number of stocks	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”.

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One of the portfolio's key clusters is "proprietorship cultures" which we often find in the form of family-linked companies ("FLCs").

In recent analysis, Credit Suisse looked globally at 1,000 family-owned companies, highlighting that this group of 1,000 companies has outperformed the MSCI AC world by 392bps since 2006[1] and that outperformance "occurred in every region, in every sector and for both small and large caps". Underlying this performance, Credit Suisse stated that FLC's "...have better revenue growth, margins, and cash flow returns than non-family-owned peers."

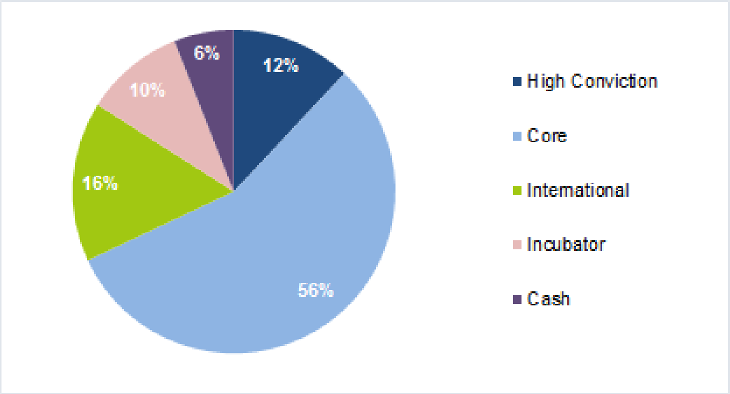
Similar to Credit Suisse's conclusions, our own experience is FLC's on average are better aligned to shareholders via their longer-term investment horizons, value creating capital allocation and counter-cyclical investing, and they tend to run much more conservative balance-sheet gearing which provides optionality to the company to invest when opportunity is most attractive.

We expect that FLCs will continue to provide a fertile hunting ground for the portfolio going forward.

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

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



The portfolio 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.

[1] "Global Equity Themes, the Family Business Playbook", Credit Suisse Equity Research, 27 September 2017

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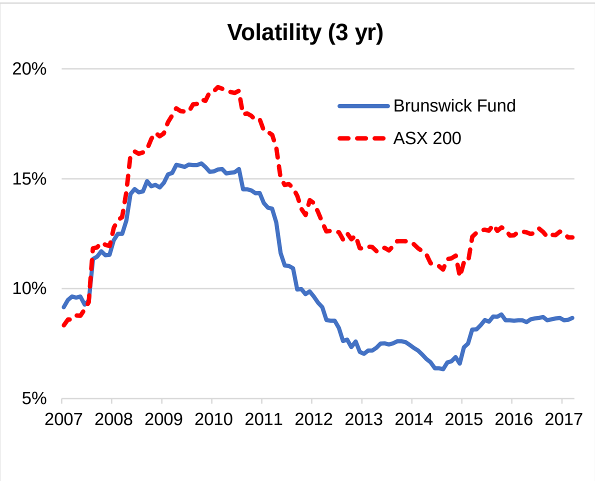
International stocks are added by leveraging Cooper Investor's global research platform. Finally, the Incubator category are stocks that require an "up or out" decision, and are generally our smallest weightings in the portfolio. The incubator category adds optionality to the portfolio where we can add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

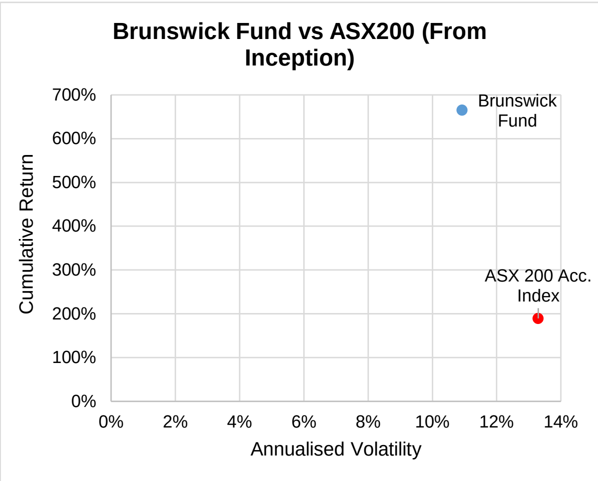
Portfolio Risk Metrics

In recent quarterlies we have added some additional information describing some of the portfolio's risk metrics, summarized below:

	*PORTFOLIO	#BENCHMARK
Total Return	+665.3%	+189.2%
Max Drawdown	-40.0%	-47.2%
Best Month	+7.4%	+8.0%
Worst Month	-10.1%	-12.6%
Positive Months	+69.0%	+63.3%
Annualised Volatility	+10.9%	+13.3%

*Cumulative (1 July 2004), before fees and expenses # S&P ASX 200 Accumulation Index





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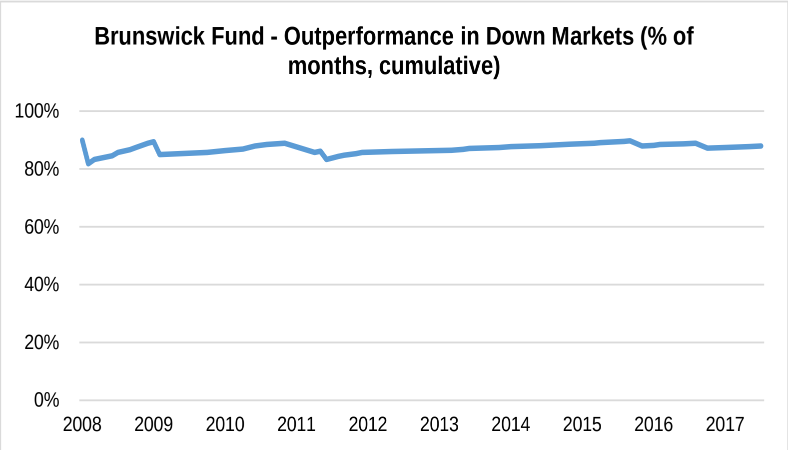
The portfolio's volatility remains below the market on both a "since inception" basis and based on a more recent 3-year time horizon.

The portfolio has also tended to outperform when the Index has fallen (51 out of 58 down months, or 88% of the time).



Industry Observations

Trip Notes

During a recent trip to New Zealand, we attended a site visit with portfolio company **Mainfreight (MFT)** at their Auckland depot, which is also the group's head office.

The site was custom designed by MFT 10 years ago, to optimise their operations and is right next to a Rail line, which comes in through the middle of the depot. Railcars are unloaded with freight sorted into destination zones and loaded into trucks on the sides for each particular destination.

We were taken around the site by the Operations Manager who had been with MFT (and its predecessor company) for 45yrs! A number of key observations/ comments made by MFT:

- Although freight is simple, operators make it difficult for themselves by not doing the simple things well (eg losing a pallet which costs of lot time trying to track down).
- MFT's focus is on LCL (less than container load) freight which has taken MFT years to get right. The tricky bit is you only make money when you can load up a truck with the right mix of weight and volume. They used the analogy that a truck full of feathers would be underweight, but a truck carrying the maximum weight of bricks would be under-filled in terms of volumes. Sometimes it's the last little high value item that drives most of the margin.
- They don't "police" their staff, motivation comes from all the staff knowing all of the details of key operating drivers and how this impacts the business (and MFT's margins). All employees understand the direct link between company margins and their own bonuses.
  - As an example, their canteen had a long board with all the key financial and operating metrics and is updated and checked every week.

- The executive team operate in an open plan area right next to the operations team with little hierarchy.
    - All of their graduates start by driving forklifts, and other jobs at the floor level.
- Walking about the site there was a feeling people like working there; with a very positive atmosphere that would be hard to replicate.

The visit reinforced our VoF proposition for the stock:

- It is a culture led firm with a significant global growth opportunity.
- It remains very focused on high quality/service to the most profitable customer segments, driven by a “shop-floor up” approach of having the right people deliver the right service to the right customers.
- Over time growth should continue to reinforce its position via increased network density, scale and better rates.

While in New Zealand we also attended a conference hosted by another portfolio stock **Heartland Bank (HBL).** The conference focused on “FinTech” or Financial Technology, and whether this is likely to be a friend or foe to incumbent banks.

In recent years HBL has carved a niche position in the New Zealand market, including as incubator and funder of new FinTech businesses such as Harmoney and Spotcap, that are trying to cut through with simpler, quicker and more convenient offering to customers, in particular Millennials who are more comfortable shopping online for banking products and services.

Globally, the Fintech opportunity appears massive. However, traction so far has been underwhelming relative to how quickly Uber, Airbnb and other disruptive models have spread.

In essence there are really two key components to banking: payments and savings and loans. So far disruption has been more evident in payments via players like Paypal and more recently the opportunity presented by the Blockchain technologies. In contrast, savings and loans remains highly concentrated in large global banks. Given this opportunity, many are targeting investment in the sector. As an example, Goldman Sachs recently developed their own personal lending platform called “Marcus” (https://www.marcus.com/).

HBL remains attractive to the portfolio as a more focused bank with a differentiated service offering, less encumbered by legacy positions in its markets and therefore more open to newer, better offering supported by technology.

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Important announcement

We would like to advise that as of Monday the 16th of October the Brunswick Fund will be closed for the foreseeable future to new and additional investments from external parties.

Since inception to the 30th of September 2017 the Brunswick Fund has out-performed the ASX 200 Accumulation Index by 8.4% per annum. An important factor in maintaining the ability of the strategy to continue to out-perform its benchmark is ensuring that the fund is able to invest in opportunities across a range of market capitalisation stocks.

For the foreseeable future we now believe, in current market conditions, that in order to protect returns for existing investors we have reached the capacity limit for the strategy.

If you have any questions about the closure of the fund to new and additional investments please contact Amanda Perry on aperry@cooperinvestors.com or 03 9660 2651.