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 2018

"Human behaviour flows from three main sources: desire, emotions and knowledge." Plato

"The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design" F.A. Hayek

"True diversification requires owning assets that respond differently to the fundamental forces that drive markets." David Swensen

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
LAST 3 MONTHS	1.8%	1.5%	0.3%
2019 YTD	1.8%	1.5%	0.3%
2018 (to 30 June)	16.0%	13.0%	3.0%
2017	13.4%	14.1%	-0.7%
2016	12.5%	0.6%	11.9%
2015	14.3%	5.7%	8.6%
2014	26.8%	17.4%	9.4%
2013	32.0%	22.8%	9.2%
2012	12.4%	-6.7%	19.1%
2011	16.1%	11.7%	4.4%
2010	18.7%	13.1%	5.6%
2009	-19.4%	-20.1%	0.7%
2008	-12.9%	-13.4%	0.5%
2007	45.7%	28.7%	17.0%
2006	35.3%	23.9%	11.4%
2005	47.6%	26.4%	21.2%
SINCE INCEPTION*	16.8%	8.7%	8.1%
SINCE INCEPTION^	810.9%	229.5%	581.4%

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

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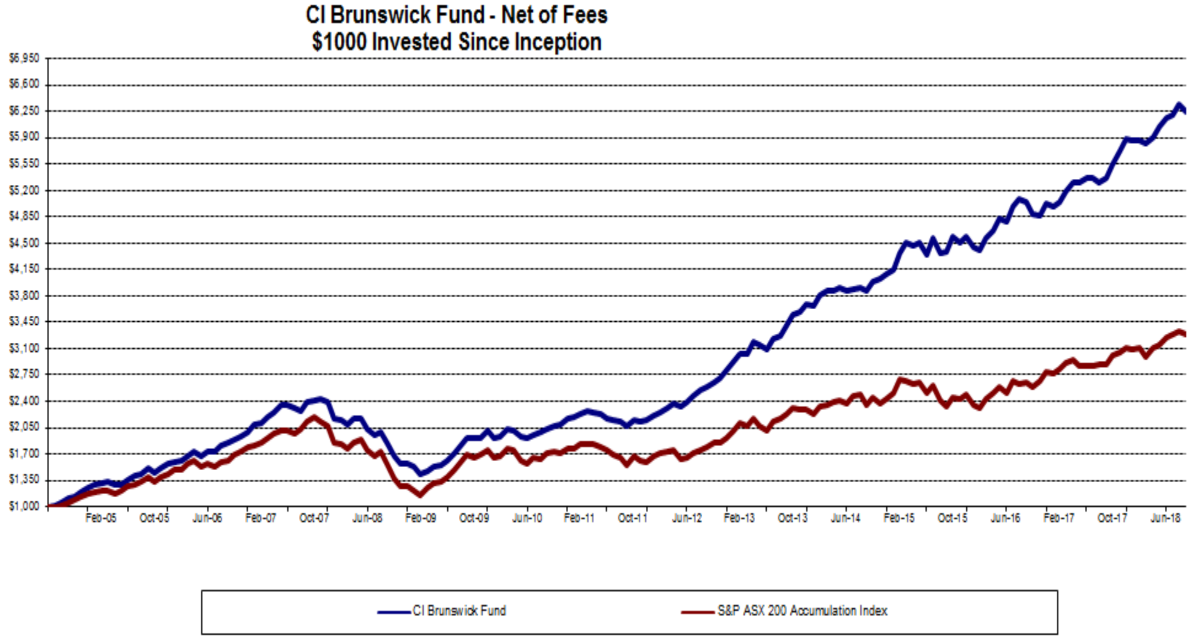

Portfolio Performance

The Brunswick Fund returned 1.8% during the September quarter 2018, which was slightly ahead of the index which returned 1.5%. The Fund returned 17.6% for the 12 months to 30th September.

Key contributors to portfolio performance during the 3 month period include **Washington Soul Pattinson (SOL**) (share price appreciation of portfolio businesses), **Brambles (BXB)** (solid FY18 result), and **Ryman (RYM**) (4th Melbourne village gets development approval).

Portfolio stocks that performed poorly include **Pact Group (PGH)** (FY18 result impacted by higher costs), **Sims Group (SGM)** (uncertainty about global trade and Turkey), and **Reece (REH)** (concern of a potential slowdown in Australian and US housing).

A long-time holding of the fund **Washington Soul Pattinson (SOL**) performed strongly during the quarter, mainly due to a large re-rating in its holding of **TPG Group (TPM)**. During the quarter TPG announced a merger with Australia's third mobile phone operator Vodafone. Prior to this, TPG had planned a rollout of its own mobile network focused on 5G technology. The merger reduces the need for additional capex and should create a much stronger rival to Telstra and Optus over the medium term.

SOL sits under our 'asset play' subset of value. For nearly 50 years SOL has had a cross-holding structure with **Brickworks (BKW)** – a stock also owned by the Fund – which creates circularity in the traded value of both companies. The listed value of SOL and BKW depend on the value of each other and at times both stocks have traded at discounts to the sum of the observable listed prices (or the non-listed parts imply very low valuations). The combination of the closing of this discount, as well as our view on the underlying asset or business value latency, is what interests us. Often, behavioural factors have influenced these discounts (liquidity, large sellers, and governance concerns are some examples).

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Despite the recent re-rating we still see value latency in both SOL and BKW. There is a large discount still present in BKW, and BKW continues to sit on land held at cost (based on very old purchase prices) which they are slowing developing via their industrial property trust (alongside Goodman).

We also see latency in the group's ownership and governance structures. SOL and BKW are family-linked companies (one of the three proprietorial management types we invest in) with the Milners acting as long-term owner-operators across various cycles. SOL sits in our "capital allocator champions" cluster. Over the years SOL has consistently demonstrated ability to invest capital in a counter cyclical manner – investing at the low points in the cycles of industries and businesses with stable, long-term, value-focused oversight.

Bega Cheese (BGA) conducted an equity raising during the quarter. Having recently bought the Koroit processing plant from Saputo, the funds raised were used to pay down debt incurred in the acquisition. Opportunities arising from the purchase include:

- Optimisation of production base
- Grow milk supply
- Product development (mozzarella, milk powder sachets)

In addition industry structure improves as this transaction is the consolidation of the industry from 4 to 3 major players. BGA have a lot on their plate (given the recent acquisition from Mondelez) but we think management and company structure are readily capable of absorbing the new facility.

Sims Group (SGM) reported a strong FY18 result during the quarter with volumes +13%, revenue +27%, EBIT +53% and dividends per share +33%. Sims collects scrap metal, shreds it into a more useable form and sells the ferrous component to blast furnaces for making steel. A key end market for Sims scrap is Turkey (~20% of volumes) with the end steel product sold both in domestic markets, which has been strong recently due to a strong domestic economy, and to export markets.

However, in the last few months Turkey has experienced a large fall in the lira, high inflation, and a significant increase in interest rates. Combined, this is expected to result in much slower domestic growth, lower steel consumption and the risk that some businesses (including steel mills) are exposed to USD denominated debt. In addition to Turkey, sales of SGM's non-ferrous product has been impacted by changes to China's import regulations. On the back of these concerns SGM's share price has performed poorly.

Despite these near-term headwinds, SGM has a number of potential offsets. Firstly, SGM is mostly exposed to the four largest steel mills in Turkey, who are more export orientated and are therefore less impacted by weakening domestic demand for steel. Secondly, even mills that are exposed domestically, have the option to change product mix from rebar (domestic) to billet (export). Finally, SGM has in recent years been managing down its exposure to Turkey by increasing sales to other end markets, which we expect will continue. From SGM's perspective, it retains a strong balance sheet and a number of ongoing improvement opportunities.

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The Portfolio – Strategy, Structure, and Process

Our single purpose goal is to identify risk adjusted value latency. At CI we take a qualitative and observation first investment approach to research and analytics. We seek to partner client capital with what we call 'Focused Management Behaviour' – companies that display enduring proprietorial qualities with the ability to deliver the value latency options afforded by good operating, industry & strategic position/trends. The management and governance cultures of the companies we seek fall into 3 broad categories:

1) FLCs – Family linked companies and/or Founder-led;
2) OOCs – Owner operator cultures; and
3) SFMs – Specialist, Focused management teams that are resetting governance & management priorities (note these categories are further discussed below in this report).

All these proprietorial management styles have the following behavioural qualities:

- Humility – authentic, energetic and long-term value obsessed
- Focus – intentional and know what they are doing
- Alignment with and respect for shareholder interests
- Deep, nuanced knowledge of business/industry
- Counter-cyclical and value-based capital allocation
- Invest in skills, talent, innovation

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 that we call the "CI Way", 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.
- We seek a spread of diverse exposures across small, mid and large capitalisation companies as well as different industries, clusters and countries (within a maximum of 25% overseas exposure. Note: overseas means non-ANZ listed stocks).
- Our focus in overseas stocks is leveraging CI's resources in the asian and global funds of 100 owned stocks and 1000 company visits p.a. At the moment, we are particularly focused on overseas stocks that are:
  - Family-linked companies
  - Asset plays
  - Low risk turnarounds and spin-offs

Structure

- Concentrated, long-only, long-term equities portfolio (20-40 stocks).
- Portfolio of companies with value latencies, across 6 subsets of value, focused around a number of key "clusters".

Process – VoF

- Repetitious implementation of the VoF process utilising CI's market access and networks.
- Take advantage of liquidity events, and market /stock dislocations.
- Small team leveraging CI's well-resourced research platform and back office strength.

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The portfolio remains positioned around six subsets of value:

- **Stalwarts** (20% of the portfolio) – sturdy, strong and generally larger companies with world class privileged market and competitive positions. (ASX, Brambles)
- **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** (36%) – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Lifestyle Communities, Xero, CSL)
- **Asset plays** (8%) – stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Soul Pattinson, Brickworks)
- **Low Risk Turnarounds** (9%) – sound businesses with good management in place and good balance sheets. We especially like spin offs and government to private turnarounds. (OHL Mexico)
- **Cyclicals** (15%) – stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. (Iluka, Adelaide Brighton)

Currently the portfolio holds around 7% cash. The portfolio has around 11% of assets invested in overseas stocks that own businesses in USA, Canada, UK and Mexico.

Portfolio attributes as at September 2018 are summarized below:

P/E	19.0
Beta	0.75
Yield	2.5
P/Book	2.4
ROE	13.2
Tracking error vs. ASX 200	5.35
Stock Number	38

Source: UBS PAS

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. They 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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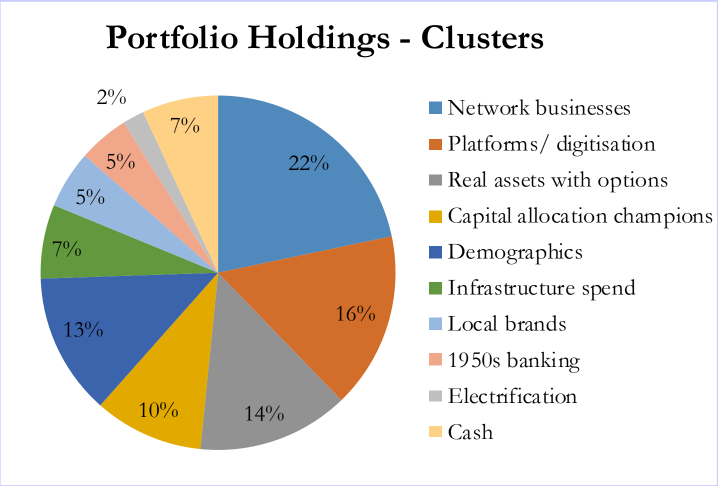
Our current focus is on the following clusters:



- **Network businesses** – sturdy, strong and generally larger companies with world class competitive positions, where growth reinforces the business model. (CSL, Reece, Mainfreight).
- **Platforms /digitisation** – companies that are at the forefront of digitising industries, preferably with software that requires investment to scale, but once scaled have a low cost of adding incremental customers (Xero).
- **Real assets with options** – companies that own real assets like property, infrastructure, minerals or agriculture products that are under-utilised, under-rented or hidden (ALE Property)
- **Capital allocation champions** – companies with a history of value-creating and counter-cyclical capital allocation/investment across a portfolio of assets. (Soul Pattinson).
- **Demographics** – companies providing accommodation or services to people aged in the 65+ age group (Lifestyle Communities).
- **Local brands** – companies with strong brands that will benefit from a trend towards local, boutique, fresh, home-grown food (Bega).
- **Infrastructure spend** – companies set to benefit from increasing spend on infrastructure, domestically or globally (Adelaide Brighton).
- **1950's banking** – banks and other financial companies with a high level of customer service backed by smart IT (St James's Place).
- **Electrification** – companies benefitting from the trend towards increasing electrification of things such as cars, and homes (TE Connectivity).

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Cluster deep dive – Real assets with options

The Bond-like-equities (BLE) category is one of our six 'sub-sets of value' and describes stocks with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. However, vanilla REITs rarely interest us, as latent value can be hard to identify. Within the BLEs sub-set, there is a cluster of companies we have called "real assets with options". Real assets include things such as:

- Precious metals
- Agricultural assets, farmland and water rights
- Real estate
- Infrastructure with very long life concessions

Real assets tend to be finite in nature, have a degree of scarcity, and are generally less correlated to overall economic activity.

Although yield can be important in assessing risk adjusted value latency in this category – dividends alone usually only underpin a base level of value. Similar to the other five sub-sets of value, sources of value latency can be wide and varied. However, in this category we are particularly interested in assets that have 'optionality'. Below is a list of sources of optionality and value latency (we have borrowed this list from William Poorvu[1]) with some relevant examples from the Brunswick Fund:

1. Repositioning (changing use, condition or repositioning) ~ **Brickworks (BKW)** selling old building materials land into its industrial portfolio
2. Using excess land for new or extended purposes ~ **ALE Property (LEP)** developing vacant land into accommodation or other purposes
3. Adding new uses to existing development
4. Buying properties at prices that reflect a lack of liquidity ~ **Eureka Group (EGH)** buying at 50-70% of replacement cost
5. Building on one's own tenancy **~ Event Hospitality (EVT) u**tilising its Hotels and Cinemas operating business across its property portfolio
6. Leasing rather than buying
7. Pre-leasing ~ **Arena REIT (ARF)**
8. Leverage ~ not a favourite of ours. We would usually be sellers when we see this happening
9. Design and construction ~ **Lifestyle Communities (LIC) and Ryman (RYM)** setting industry standards for quality and consistency in their various categories
10. Customer service ~ **Lifestyle Communities (LIC) and Ryman (RYM)**

These value latencies become more interesting to us when they are lower risk due to strong operating trends afforded by a niche end market focus (pubs, aged accommodation, childcare, healthcare), and when operated by proprietorial management teams.

[1] Co-founder and Co-Chairman of the Baupost Group

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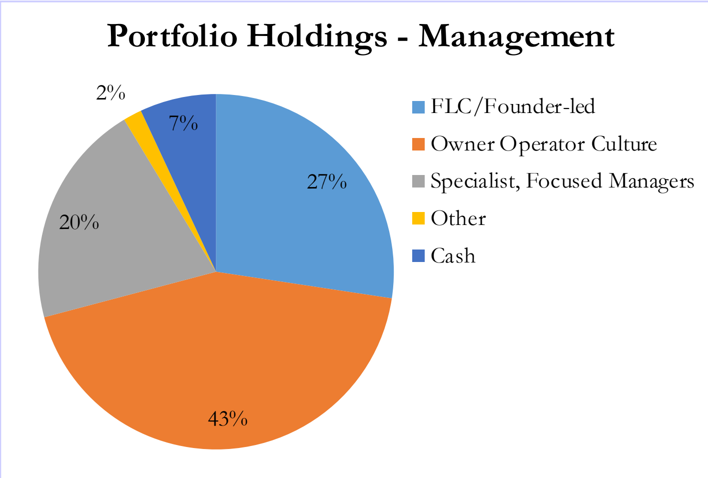
Focused Management Behaviour
The portfolio is focused on three broad management categories:



- **Family-linked Companies (FLC) and Founder-led** – FLC's provide a governance framework that preserves strong cultures over longer timeframes. Founder-led firms with strong leaders can set the standard for a company's culture.
- **Owner Operator Cultures** – companies that demonstrate the behavioural qualities we seek with evidence these attributes have seeped into the company more widely than just the current management team.
- **Specialist, Focused Management Teams** – management teams displaying high levels of experience and focus, often where there has been. a "re"-focus of governance and management priorities. This still requires evidence of the behavioural qualities we seek which can come from a new management team, from changes to company structure (eg spin-offs, or government to private), or from reconnecting to old or latent culture.

Owner Operator Cultures – Xero

During the quarter (and similar to last year), we attended 'Xerocon' in Brisbane, Xero's annual conference for accounting partners in Australia. The scale of Xerocon is hard to imagine without being there yourself. The event was attended by 3,702 people, mostly accountants, most of whom pay to go! In addition, there were perhaps 100 or more of Xero's ecosystem partners (related software) with exhibition stands. Accountants come to hear from the leaders of Xero about product developments and what is coming in the future. What is clear from being at Xerocon is the embedded momentum in the business is significant – the ~3500 accountants represented ~650k small businesses in Australia.

For us what sits behind this operating momentum is the firm's culture. Culture incorporates many things such as beliefs, rituals, values, behaviours, norms, and interacts with other more identifiable things like strategy, organisation and operating models. In our view good culture leads to both good strategy and good execution. Xero sits within the 'owner operator culture' group of our proprietorial managers.

Culture and leadership are also clearly linked. For founder-led firms (another type of proprietorial management team we invest in), the founders lead the way in defining the culture of the firm. Great leadership provides clarity of vision and is able to align the organisation tightly behind that vision.

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The strength of Xero's culture lies in part in Rod Drury's (the founder) ability to shape the company's vision.

> *"I think what really works at Xero, why there are so many evangelists for Xero and why people truly love Xero, is we have a really clear vision, and we incrementally deliver on that vision."*
> Rod Drury

Importantly, at Founder-led firms, clear vision can create drive and focus well ahead of other companies where vision becomes diluted by legacy systems, management teams and beliefs. In Xero's case, as Rod steps back, his vision has enabled the transition to an owner operator culture.

Rod spoke at Xerocon about driving his Tesla on autodrive. At first he kept his hands very close to the wheel around tight corners. Eventually he realised the car was much better at these tight corners than he was (his role was best seen as oversight). He sees things playing out similarly in accounting (in the analogy the accountant is Rod driving, and Xero is the car), which is why XRO are investing heavily in machine learning.

Our work to understand culture is qualitative and requires multiple, ongoing meetings. For XRO this included multiple meetings with management in Australia and the UK, meeting with competitors in Australia, UK, and the US, meetings with former employees, accountants, and other experts, as well as attending Xerocon, and visiting their offices at different locations.

XRO also provided many hints at some of the value latency that still exists in the business, underpinned by its culture. At the heart of XRO's success is the significant improvement in customer value offered by its product. XRO has taken accountants and small business from a manual process of collecting receipts, maybe recording them in excel and in many cases only getting periodic statements of performance to an always updated, online view of their business. Key to this was the innovation around bank feeds which Xero led that allows transactional data to feed a general ledger, learning over time how it should categorise this data. Combined with mobility and the cloud, this led to a step change in benefits for small business.

In many ways this revolution is really only beginning. An accurate ledger requires an up to date view on payables and receivables – the 'known knowns' of cash flow forecasting. Here the effort is in collecting information from disparate sources. XRO and its ecosystem partners are focusing on how to best ingest their clients bills, which are then stored online and automatically sent to the ledger (the recent acquisition of Hubdoc for example does all this work). The automation gain from this is potentially significant and represents latent value for XRO in our view. A small business might be paying XRO $700 /year at the moment for its cash book product plus payroll. However, it is still paying a bookkeeper perhaps $10k per year to deal with all of the manual data entry.

The great thing for XRO is that much of its growth is reinforcing. Analogous to companies with physical assets, for example manufacturing companies with large scale plants, or distribution companies with dense footprints, size creates barriers to competition. For XRO, the general ledger is the central part of the ecosystem – it is the scaled product. R&D invested in the platform is the equivalent of the large physical plant. Interestingly it has been difficult for the incumbent players to reinvent their model with Xero enjoying a massive advantage in being purely cloud. This does point to the likelihood that only a few global players will be successful. Given XRO is only really in ANZ with very good momentum in the UK and early stages in the US, the geographical latency also appears significant.

Our focus is partnering client capital with companies that display enduring proprietorial qualities with the ability to deliver the value latency options afforded by good operating, industry & strategic position/trends. Even with recent management changes and a strong share price performance, the VoF proposition for XRO remains attractive.

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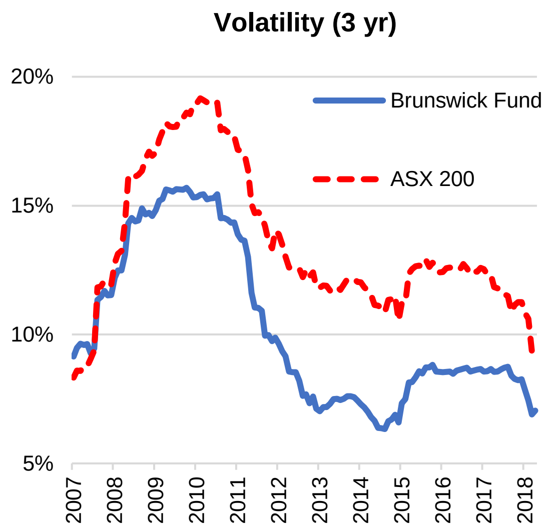
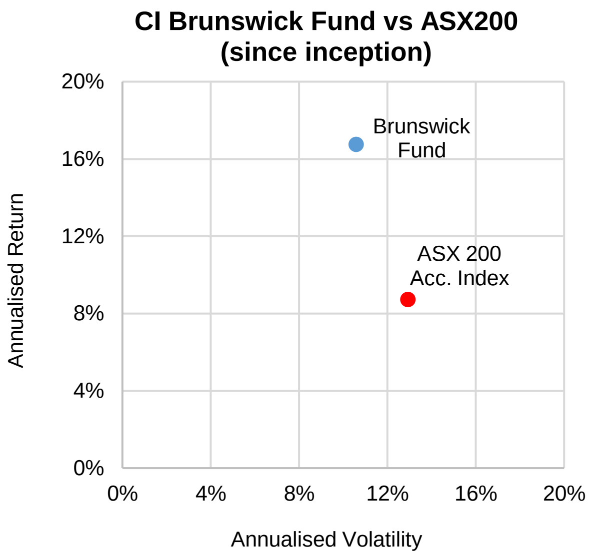
Portfolio Risk Metrics

The portfolio's volatility remains below the benchmark, driven by the portfolio's more diverse stock holdings and lower concentration risk to the big 4 Banks and large resource companies:

	*PORTFOLIO	#BENCHMARK
Total Return	+811%	+229.5%
Max Drawdown	-40.0%	-47.2%
Best Month	+7.4%	+8.0%
Worst Month	-10.1%	-12.6%
Positive Months	+69.0%	+63.7%
Annualised Volatility	+10.6%	+12.9%

*Cumulative (1 July 2004), before fees and expenses
S&P ASX 200 Accumulation Index
Max Drawdown for the Brunswick Fund occurred December 2007 to February 2009
Max Drawdown for the ASX200 Accumulation Index occurred November 2007 to February 2009
Best Month for the Brunswick Fund was November 2004, for the ASX200 Accumulation Index March 2009
Worst Month for the Brunswick Fund was October 2008, for the ASX Accumulation Index it was also October 2008





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Team Update

Justin O'Brien is now joint Portfolio Manager for the Brunswick Fund, having spent 2.5 years working on the Fund as a Research Analyst. Peter Cooper will remain Portfolio Manager for the Fund.

Justin has 16 years of experience as an investor (bought his first stock 18 years ago), research analyst and consultant and during that time has worked across many different industries /companies and through a number of (hubris to humility) investment cycles. Justin started work in the original dotcom boom and bust, mostly in consulting. He then went to London in the credit boom of 2006, working with Credit Suisse through the GFC period. Immediately prior to CI he worked with Diogenes Research, analysing earnings "quality" issues across ASX300 stocks.