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.

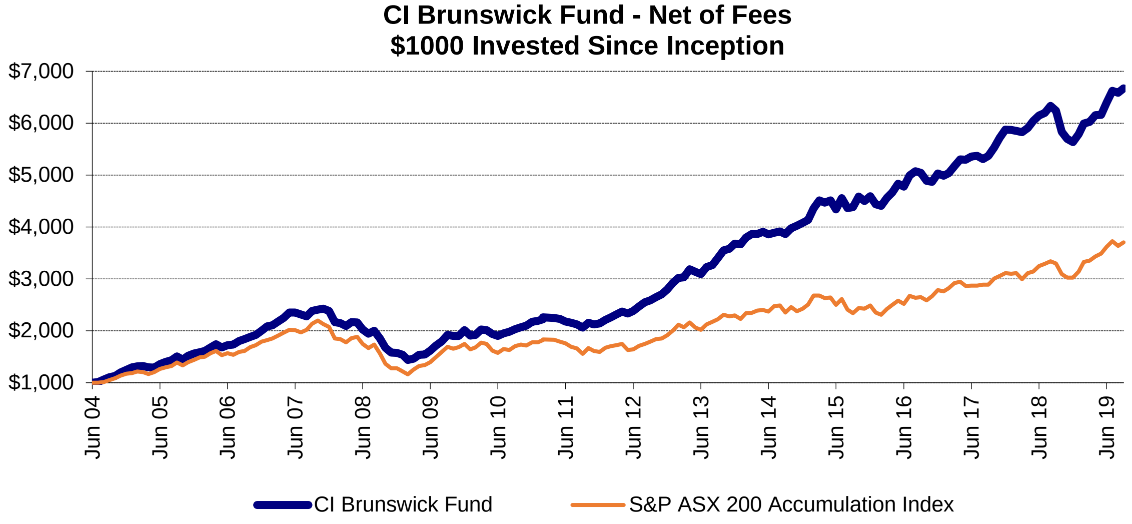
SEPTEMBER 2019

The Brunswick Fund Proposition

"The Brunswick Fund's mission is to deliver above market returns by <u>leveraging</u> CI's VoF philosophy and the fund's <u>unconstrained</u> investment universe. The strategy is to be less volatile to the downside and capture upside by investing in <u>quality</u> companies that display <u>proprietorial</u> management behaviour. There are 3 <u>competing</u> capital pools ~ compounder, reversionary and real income/assets securities, so we are always redeploying income and surplus capital into the best risk adjusted value latency opportunities"

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
LAST 3 MONTHS	4.6%	2.4%	2.2%
FY 2020 YTD	4.6%	2.4%	2.2%
FY 2019	5.1%	11.5%	-6.4%
FY 2018	16.0%	13.0%	3.0%
FY 2017	13.4%	14.1%	-0.7%
FY 2016	12.5%	0.6%	11.9%
FY 2015	14.3%	5.7%	8.6%
FY 2014	26.8%	17.4%	9.4%
FY 2013	32.0%	22.8%	9.2%
FY 2012	12.4%	-6.7%	19.1%
FY 2011	16.1%	11.7%	4.3%
FY 2010	18.7%	13.1%	5.6%
FY 2009	-19.4%	-20.1%	0.8%
FY 2008	-12.9%	-13.4%	0.5%
FY 2007	45.7%	28.7%	17.1%
FY 2006	35.3%	23.9%	11.4%
FY 2005	47.6%	26.4%	21.2%
SINCE INCEPTION*	16.2%	9.0%	7.2%
SINCE INCEPTION^	844.5%	270.6%	613.9%

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



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"Far too many executives have become more concerned with the four 'P's' – pay, perks, power and prestige – rather than making profits for shareholders"

- T. Boone Pickens

"All the opportunity in the world means nothing if you don't actually pull the trigger"

- Sam Zell

Market and Portfolio Performance

The ASX200 Accumulation Index rose 2.4% over the quarter, again pushing past numerous global areas of concern, and following the lead of the Dow Jones and S&P500 indices which both rose by a similar amount. Bond yields fell in Australia and the USA as markets anticipated further rate cuts which duly occurred. The Federal Reserve cut rates by 25bps, its second cut in the space of three months, while the RBA cut rates in both July and October by 25bps on each occasion to leave rates at a historic low of 0.75%. Inflation remains benign and there are growing worries about the global economy in light of a litany of uncertainties.

During the quarter, the Brunswick Fund performed relatively well, increasing 4.6%.

Key contributors to portfolio performance include **Lifestyle Communities (LIC**) (acquired a new site and senior debt facilities to support medium-term growth), **CSL (CSL**) (strong FY19 result), and **Aurizon (AZJ)** (negotiation of a commercial agreement in its regulated "below rail" business).

Portfolio stocks that performed poorly include **Brambles (BXB)** (earnings shortfall as a result of issues with the pallet pools in both Canada and Latin America), **Elmo (ELO)** (capital raising to fund organic and inorganic growth) and **Mainfreight (MFT)** (concern that global trade and economic activity are slowing).

In August the Brunswick Fund participated in the IPO of **Napier Port (NPH)**. The Port fits into our "reversionary" category as a public to private opportunity, having been previously owned by local council. In our experience, government or public ownership results in various sources of value latencies. Put simply, the latencies exist because it's much less likely the business has been commercially 'optimised' under government ownership.

Napier Port is located on the East Coast of NZ's North Island and is primarily export focused with a largely captured customer base comprising logs, woodpulp and pipfruits. Importantly, the IPO proceeds will be used to increase the value of the underlying asset via expanding port capacity which is expected to complete in 2022. The new wharf is required following recent strong volume growth and an expected "wall of wood" which needs to be harvested in the coming decade. Timber is the third largest export for NZ, behind dairy and meat-related products. In addition, the Napier region is renowned for its attractiveness for growing pipfruits, with offshore demand for this fruit growing strongly in recent years.

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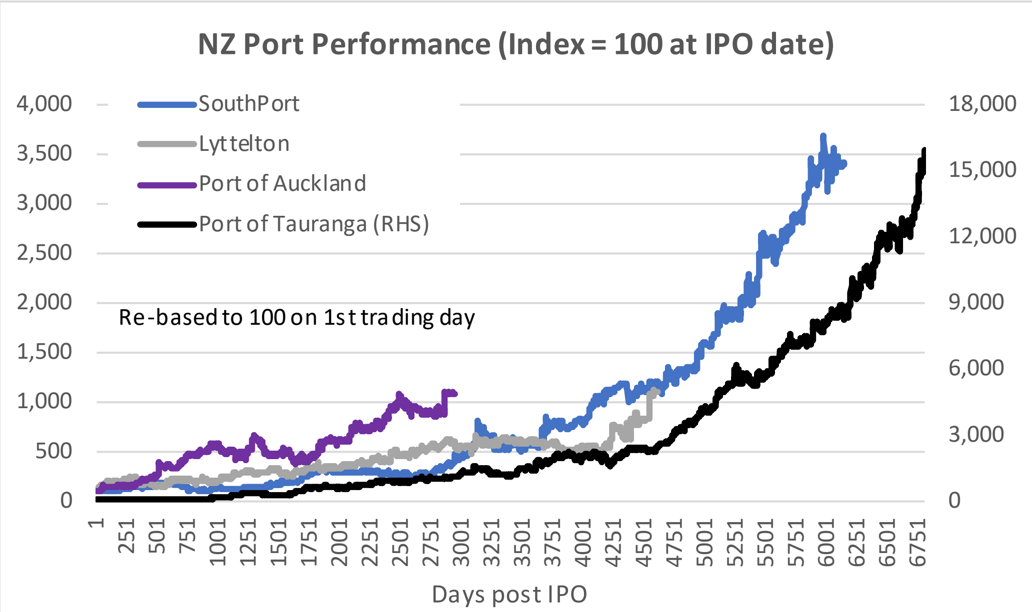
NZ Port IPO's have historically demonstrated strong outperformance over long time periods:



	TSR CAGR	Time period listed (yrs)
Port of Auckland	23%	12
Lyttelton	14%	18
Port of Tauranga	20%	27
South Port NZ	15%	24

In our view, Napier demonstrates some of the characteristics which have contributed to the outperformance shown above. These include:

1. Under-optimized cost base – high wage growth per employee over the past 5 years resulting in much lower incremental margins than peers;
2. Scope for productivity improvements – trends in both freight handled per employee and crane rate have underperformed peer trends;
3. A gold-plated existing asset base, with capex >2x D&A over the past 5 years;
4. IPO proceeds urgently required for capacity expansion; and
5. A fair to attractive pricing at listing.

Napier Port's Annual Reports from the past 15 years are also readily accessible resulting in lower levels of information asymmetry relative to the vast majority of IPOs. While we expect some short term volume and earnings risk from a recent decline in log prices (~25% past 6 months), history suggests the price decline will be short lived. Regardless, we think there is significant latency in the cost and asset base for operational improvements as the port transitions from 100% council ownership.

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Brickworks (BKW) released its FY19 result during the month of September with a strong performance from its Industrial Property division partially offsetting a currently challenging Australian Building Products environment (softer Housing, higher energy costs) and lower Investment Earnings from Soul Pattinson (SOL). BKW fits into our Asset Play subset of value with its diversified look through asset exposures of Building Products (23% Aus & US), Industrial Property (21%), Energy (22%, within SOL) and TPG (19%, within SOL). The company continues to trade at a sizeable discount to its sum of the parts (majority listed equities) despite operating trends strengthening for the majority of its large exposures providing the potential for both NAV growth and discount contraction. We remain attracted to BKW's focused management behaviour with CEO Lindsay Partridge having been with the company for 34 years and the SOL cross-shareholding and family linked culture supporting a counter-cyclical capital allocation mindset.

The **Lifestyle Communities (LIC)** FY19 result was in line with expectations having been well flagged to the market. FY20 settlements (270-310) however are expected to be lower than FY19 (337) due to delays in receiving planning permits for two villages – Wollert North and Kaduna Park – which we view as largely a timing issue. More importantly, management provided settlement guidance for FY21 of 370-420, which points to a medium-term sustainable settlement run-rate of c400 homes pa (or 2 new villages pa). This is higher than what we had assumed in our forecasts and we would not be surprised if there is upside risk to settlement rates over the medium-to-long term.

Demand continues to be supported by LIC's strong affordability proposition, increasing brand recognition, and the long runway of growth in Greater Melbourne. Sentiment in the housing market also appears to be improving, which has been a major concern for the market over the last 12-18 months. Encouragingly, there has been little observable impact from lower house prices in Melbourne for LIC, with average FY19 sales prices for new homes +17% and resold homes +11% (albeit some of this is due to mix). Days from sale to settlement had moved out by around 30 days but industry feedback suggests this has now started to come back in as the housing market improves.

In July Tim Poole announced he would retire as Chairman of LIC in August 2019, having been a Director since 2007 and Chairman since 2013. Tim will be succeeded by Phillippa Kelly who joined the Board in 2013 and is currently Chair of the Audit Committee. We commend Tim for having done a superb job over his time at LIC and look forward to Phillippa taking up the reins. Also worth mentioning is that LIC was included in the ASX 300 Index as part of the September 2019 quarterly rebalance, which is another positive milestone in the company's journey.

During the quarter we received further evidence that Independent Living operator, **Eureka Group (EGH),** has stabilized its core business (+11% earnings growth in FY19), progressed its non-core divestment program (for example Terranora Unit sales once complete equate to ~15% of its market cap) and strengthened its management capabilities (new COO and CFO both commenced in early CY19).

EGH sits in our "reversionary" category as a low risk turnaround with a number of defensive characteristics including its land-backing, quasi Government backing (Pension funded rent), its growing industry/target market (females aged 70-85 forecast to grow at 2.75x the broader population over the next decade) and a business which is generating meaningful free cash flow.

Over the past two years we have played a significant role in renewing the Board and management team, refocusing the group on its core rental accommodation offering, and pushing for it to move away from the riskier development projects that had taken much of management's time and attention in recent years.

Post this refocus which included a number of asset sales, EGH now has significant balance sheet capacity combined with management capability to restart its acquisition pipeline. Since EGH is significantly sub-scale (Corporate Overheads >70% of PBT) and industry pricing remains attractive for consolidating these assets, bolt-on acquisitions have the potential to generate highly attractive incremental returns and value accretion for shareholders.

Without incorporating acquisitions, the company trades on a 12x PER (30% discount to ASX300) and a 20% discount to its conservatively stated book value, which itself is predicated on a relatively high (vs other property company valuations) 10.22% cap rate.

During the quarter **Reece (REH)** announced the acquisition of another business in the US plumbing market, Todd Pipe. At $160m, this acquisition is much smaller than Morsco ($1.9bn), but suggests that REH remains confident in their ability to further grow in the US market. The acquisition adds another sub brand and 6 branches to California, where REH/Express Pipe & Supply already has 14 locations. California is clearly a very large market and this will add to their supply power locally.

REH is a family-linked/proprietorial management team operating a quality ANZ business with a long runway for growth in the more fragmented (and still below mid-cycle) US market.

During the quarter, portfolio stock **Ferguson (FERG)** and competitor to REH in the US, reported its FY19 results. Although FERG's Q4 sales growth slowed to low single digit, FERG still managed to deliver double digit EPS, free cash flow and dividend per share growth for FY19, with cost savings one driver of profit growth in the quarter.

Our original investment case for FERG was based on its attractive headline valuation vs peers, strong balance sheet, no.1 position in the US, strong culture, industry consolidation runway and its UK listing which has kept it under the radar.

Since our investment, a new Chairman with a strong track record of generating shareholder returns was elected. More recently, activist investor Trian has agitated for change, resulting in the proposal to demerge the UK business and review its listing domicile. In addition, Kevin Murphy (head of US) will take over as group CEO. All of this, we believe will continue to support our VoF proposition over the next couple of years.

Steadfast (SDF) reported a strong FY19 result with NPATA +18%, comprising ~11% organic and 7% via M&A. Post the recent acquisition of the IBNA broker network, SDF becomes the dominant network locally with ~$7.1bn of gross written premium versus Ausbroker's $2.5bn.

Operating trends remain positive. SDF commissions are linked to insurance premiums paid which have been hardening (increasing) due to trends in the underlying insurance industry. For example:

- Underwriting loss rates are still high vs long-term averages, and investment income is very low (insurance underwriters need to increase premiums to make sufficient profit).
- Lloyd's continue to reduce capacity, including in Australia, with a clear mandate to improve profitability over the next couple of years.

- Reinsurance rates are trending up, with industry loss rates poor

Our VoF proposition for SDF is based on its network of brokers/agents who provide a “people-centred” offer to SME’s seeking advice on complex insurance products, which is difficult to disrupt. SDF has leading edge IT and scale (37% market share) which are compelling reasons to join and stay in the network. SDF has the opportunity longer-term through consolidation to continue to shift industry economics in their favour, while the Steadfast network of brokers provides a low risk pipeline of investments. The stable broking industry supports long-term compounding and SDF's stalwart characteristics, which is overseen by CEO Rob Kelly, who has more than 50 years in the industry, having started his career as a broker.

As we had expected, and part of our investment thesis, **Aurizon (AZJ)** completed the internal restructure of the above rail and network businesses. While deciding to remain an integrated business for the time being, the restructure will essentially allow the network business to be geared more in line with other infrastructure businesses and enable circa $1.2B of further debt capacity. We expect these funds will be deployed into capital returns to shareholders or other value accretive opportunities.

AZJ is also undertaking a number of initiatives to drive operating efficiency. This includes the introduction of precision railroading as well as a reduction in train drivers via automation. Precision railroading has added significantly to operating performance, margins and returns for the US operators such as CSX and more recently Canadian Pacific. While there are differences in the Australian sector vs the US, we expect some improvement is achievable over the next few years.

The Portfolio – Strategy, Process and Structure

Objective & Structure

Provide long-term returns above the ASX200 Accumulation Index via:

- Long-only, focused portfolio.
- Non-index, endowment-like philosophy across domestic and international markets.
- No leverage, no derivatives, no shorting.
- Concentrated, long-term equities portfolio (20-40 stocks) with VoF qualities.
- Small team leveraging CI's well-resourced research platform and back-office strength.

Differentiated Strategy

1. "Pure" application of CI's VoF Philosophy:
   - Benchmark unaware.
   - 3 competing pools of capital – Compounding, Reversionary, and Real Assets and Income.
   - Focus on companies with proprietorial VoF behaviour.
2. Limited capacity:
   - Event and liquidity opportunities (ELOs), sell downs, IPOs and spin-offs.
   - Quality small and mid-cap opportunities.
3. Access to the CI global stocks:
   - Leverage to CI's global research (up to 25% of Fund).
   - World-class global and regional champions.
   - Australian equities global comparison companies.

Process

Our singular goal is to identify 'risk-adjusted value latency' diversified across 'subsets of value' by focusing on businesses that have:

1. Identifiable value latencies.
2. Good operating trends and strong industry/strategic positions (with enduring qualities).
3. Focused Management Behaviour ('proprietorial' managers with skin and soul in the game).

The Fund stocks can be grouped into three key areas or capital pools:

1. **Compounding sources of value – Growth and Stalwart companies**
   - World-class global, regional and domestic business with preferential businesses or assets and a pathway to future underappreciated value options.
   - Currently, we are focused on companies exposed to:
     - Ageing and Health.
     - New Economy (particularly software businesses).
     - Data and Telco infrastructure.
     - Everyday needs.

- **Stalwarts** (28% of the portfolio)
  - Sturdy, reliable and generally larger companies with world-class privileged markets and competitive positions. (ASX, Brambles)
- **Growth companies** (25%)
  - Growing companies with value propositions identifiable by traditional value metrics and run by focused, prudent and experienced management. (Lifestyle Communities, Xero, CSL)

2. **Reversionary sources of value – Cyclicals and Quality Turnarounds**
   - In particular, we like spin-offs, privatisations and large-cap liquidity events (such as sell-downs) where management is in place with a plan for unlocking value, with follow-on value creating opportunities, and the assets are attractive to other potential owners.
   - At the moment, we are focused on:
     - Cyclicals in the agriculture sector exposed to drought.
     - Cyclicals exposed to US housing.
     - Infrastructure privatisations.
   - **Cyclicals** (4%)
     - Stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. (Ferguson)
   - **Quality turnarounds** (8%)
     - Sound businesses with good management and balance sheets. We especially like spin-offs and government-to-private turnarounds. (Graincorp, Napier Port)

3. **Real asset and income sources of value – Bond-Like Equities and Asset Plays**
   - This includes holding companies, Listed Investment Companies (LICs), infrastructure and specialised real-estate companies and other asset-rich companies with growth and hidden value options, and catalysts for capturing value.
   - At present, we are focused on:
     - Social infrastructure
     - Family-linked holding companies
     - European conglomerates
     - Overcapitalised Japanese companies
   - **Bond-like equities** (12%)
     - Stocks backed by assets (infrastructure, property, utilities etc) with secure, low-volatile earnings and dividends that can be grown and recapture inflationary effects over time. (ALE Property Group, Arena REIT)

- **Asset plays** (14%)
  - Owner, operator managers with long term commitment to shareholder's growth in asset value. Stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Brickworks)

We seek to partner with focused managers that display enduring proprietorial qualities with the ability to deliver the value latency options afforded by good operation, industry and strategic position/trends. The management and governance cultures of the companies we seek fall into 3 broad categories:

1. Family-linked and founder-led companies.
2. Owner-operator cultures.
3. Specialised, focused managers who are resetting governance and management priorities.

All of these proprietorial management styles have the following behavioural qualities:

- Focus – intentional and know what they are doing.
- Humility – authentic, energetic and focussed on long-term value.
- Alignment with and respect for shareholder interests.
- Deep, nuanced knowledge of the business/industry.
- Value and risk-based capital allocation (often counter-cyclical).
- Invest in skills, talent and innovation.

At the end of the period, the portfolio held around 9% cash and has around 21% of assets invested in overseas stocks that own businesses in USA, Canada, UK and Mexico.

Portfolio attributes as at 30 September 2019 are summarised below:

P/E	17.8
Beta	0.73
Yield	2.6
P/Book	2.3
ROE	12.6
Tracking error vs. ASX 200	5.02
Stock Number	31

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Trips

Similar to last year, we attended Xerocon in Brisbane. A number of themes are relevant to our VoF proposition for XRO:

1. Regulatory tailwinds are still evident:
   - Head of ANZ, Trent Innes stated – *"60% of SMEs are still to register for single touch payroll in ANZ"* – deadline is end of September 2019! … *"we are going after this aggressively".*

2. While short-term momentum in ANZ is strong, they are looking ahead to sub-growth (volumes) maturing:
   - Increasing vertical /industry focus to deepen product offering;
   - Pushing further into providing insights;
   - Potential to grow into higher priced mid-market.

3. Digitisation still has a long runway:
   - Accountants and book-keepers still spend 30% of their time on manual data entry;
   - Hubdoc (automatic importing of documents/receipts into XRO, recently acquired by XRO) is now processing 2x the amount of data it did 2yrs ago.

4. "Partnering" (with accountants) emphasised as a differentiator to Intuit (Quickbooks):
   - There was significant time dedicated to outlining new partner tools ~ eg a cashflow projection tool.

5. XRO's ecosystem (hundreds of partners that "link" into XRO) is closer to a tipping point:
   - Salesforce's ecosystem value is currently estimated at 5x the size of salesforce itself;
   - XRO estimating they are now at > 1x value (ie the ecosystem is generating more value for partners than it is for XRO);
   - XRO should be able to increasingly extract value from its ecosystem. Salesforce generates 15% of its revenue (at presumably very high returns) from platform/ecosystem partners, vs 5% for XRO.

6. Importance of payments has been elevated ~ Xero to benefit through growth in transaction (volume based) fees over time:
   - XRO are adding automation and integrations around payments;
   - Focused on selling the cashflow benefits to SME's by having payments integration;
     - Highlighted that XRO customers paid via the platform wait only 10 days on average, vs 24 days outside the platform. They also spoke about a potential $7bn working capital benefit (ANZ total) to small business if they can call in late payments from big business.
   - "Stripe" are one of XRO's key partners having a "deep integration";
     - Stripe provides a one stop shop for SMEs for payments with integrations to Visa, Mastercard, Amex, Alipay, etc. Stripe also white-label payments for Shopify ~ who have 800k ecommerce businesses globally.

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XEROCON

Portfolio Risk Metrics

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

	*PORTFOLIO	#BENCHMARK
Total Return	+885%	+271%
Max Drawdown	-40.0%	-47.2%
Best Month	+7.4%	+8.0%
Worst Month	-10.1%	-12.6%
Positive Months	+68.9%	+63.9%
Negative Months	31.1%	36.1%
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, it was March 2009.
Worst Month for both the Brunswick Fund and the ASX Accumulation Index was October 2008.

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