

CI AUSTRALIAN EQUITIES 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.

MARCH 2021

“The financial history of the last century shows a steady increase in the amount of public indebtedness. Nobody believes that the states will eternally drag the burden of these interest payments. It is obvious that sooner or later all these debts will be liquidated in some way or other, but certainly not by payment of interest and principal according to the terms of the contract.”
Ludwig von Mises

“The primary cause of cyclical fluctuations must be sought in changes in the volume of money which, by their occurrence, always bring about a falsification of the pricing process, and thus a misdirection of production. The ‘elasticity’ of the volume of money at the disposal of the economic system forms the ‘necessary and sufficient’ condition for the emergence of the Trade Cycle.”
Friedrich Hayek

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	4.61%	4.26%	0.35%
ROLLING 1 YEAR	37.09%	37.47%	-0.38%
ROLLING 3 YEAR	10.61%	9.65%	0.96%
ROLLING 5 YEAR	10.96%	10.25%	0.71%
ROLLING 7 YEAR	10.05%	7.70%	2.35%
ROLLING 10 YEAR	11.22%	7.95%	3.27%
SINCE INCEPTION*	12.21%	8.64%	3.57%
SINCE INCEPTION^	765.78%	372.50%	393.28%

*Annualised

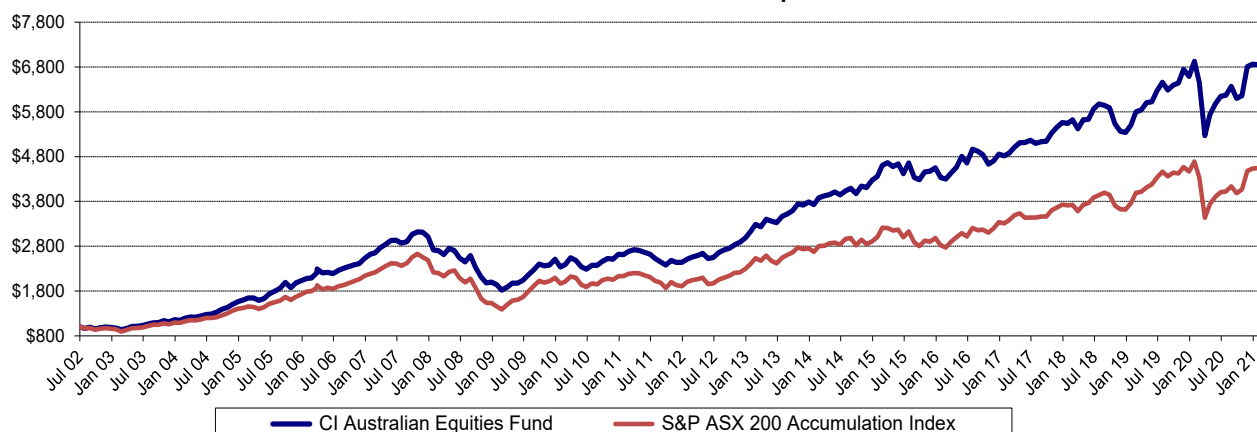
^Cumulative (4 July 2002)

**Before fees and expenses

#S&P ASX 200 Accumulation Index

Past performance is not necessarily a reliable indicator of future performance

**CI Australian Equities Fund - Net of Fees
\$1000 Invested Since Inception**



Source: NAB Asset Servicing

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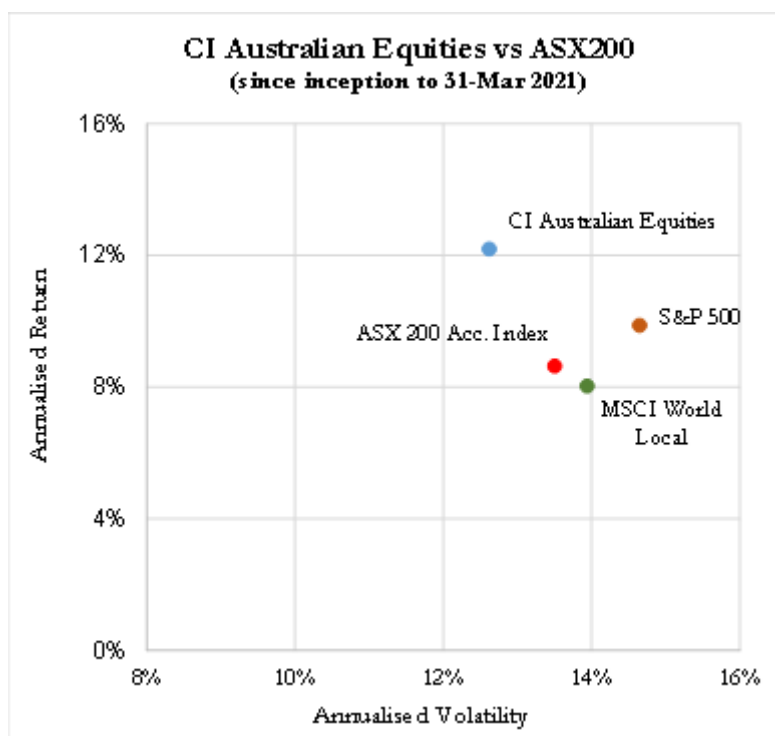
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Market and Portfolio Performance

The ASX200 Accumulation Index rose 4.3% over the quarter, and has now risen every month for the last six months, and in eleven of the last twelve months. In so doing it is now within a whisker of fully recovering its losses of a year ago and is up 37.5% over the twelve months. A remarkable feat in light of the ongoing Covid issues in many parts of the world. Although 10-year bond yields have risen (US and Australia both from circa 90bps to approximately 1.7%), reserve banks have been public about keeping short rates on hold at all-time lows until they see signs of real inflation and employment gains – so money remains cheap and is supportive of equities markets

The banks continued their strong run with the sector rising 16% while the telecommunications sector rose 13.7% on the back of a takeover bid for Vocus and a stronger Telstra performance. The technology sector took a breather falling 11%, and healthcare fell 2% with CSL the main detractor falling 6%. From a portfolio perspective the better performers included News Corporation (strong half year result), Oz Minerals (rising copper price) and Reece Limited (strength in the US housing market) while detractors from performance included Northern Star (falling gold price and departure of the chairman Bill Beament), Altium (weaker than anticipated result) and Ampol (weak refiner margins and uncertainty around refinery closure).

Bond markets experienced a rise in long-term yields as confidence in the recovery translated to expectations of higher interest rates. In Australia the 10-year bond yield retraced to levels above where they were pre-covid:

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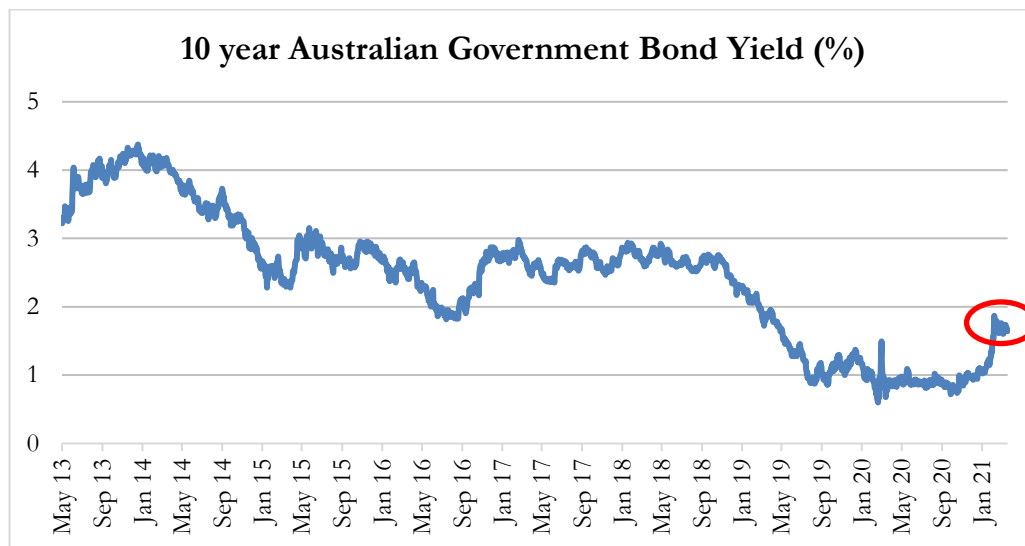
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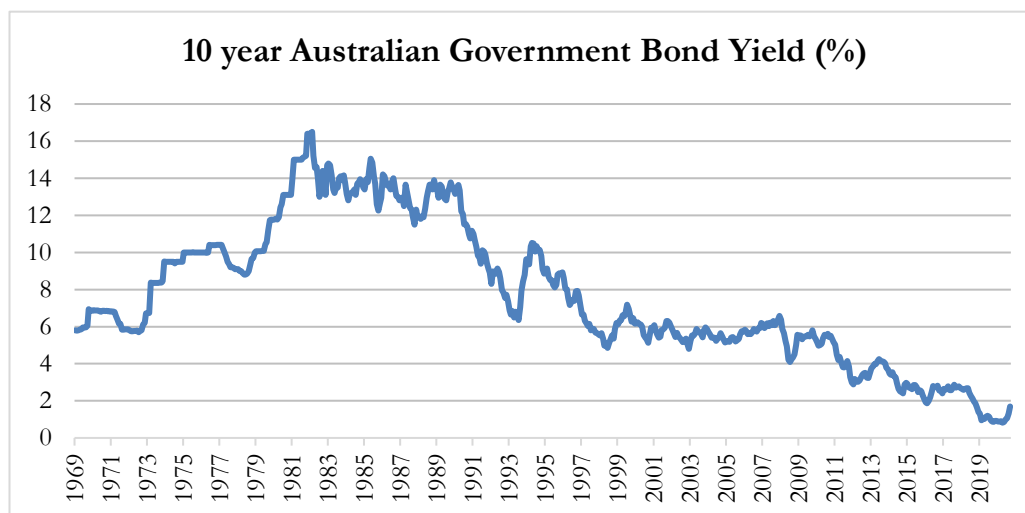
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Source: RBA

While the retracement was significant in the context of recent trends, it was small relative to the long-term trend – a 40 year fall in yields:



Source: RBA

Higher bond yields are not in themselves a concern for stock markets, particularly as Australia's Reserve Bank has signalled that expansionary policy (near zero rates) will remain in place until at least 2023, which should be broadly positive for companies and the economy.

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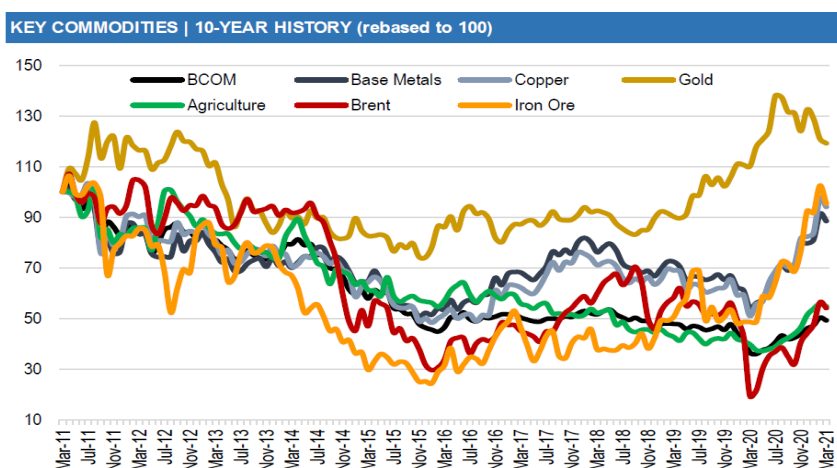
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However, higher/lower yields impact certain stocks disproportionately. For example, some higher growth stocks have benefitted from very low yields in recent years. These stocks 're-rated' on the view they provided access to scarce growth. During the March quarter some of these stocks 'de-rated' as yields reverted.

While some stocks in the Fund were impacted, there were positives and negatives at a stock level which broadly netted off. CI's investment beliefs are not anchored to any of the traditional styles of growth, value or income, for example. Rather, our 'CI Way' of investing is focused on building portfolios of companies with risk-adjusted value latency ~ stocks with identifiable latent value, where operating, industry and strategic trends are positive and management teams display the intent to take advantage of opportunities.

One of the topics du jour, and very relevant to the path for interest rates, is inflation. We have been observing not insubstantial cost increases at the input level of supply chains but, as evidenced by the inflation charts below, these have yet to manifest themselves in pricing for finished goods and hence in official measures of inflation. Copper, iron ore and oil are three commodities where prices have risen sharply from their covid lows of a year ago (see chart below), while lumber and resin prices, as well as freight costs, have accelerated more recently. To date the large amounts of liquidity created by reserve banks, combined with government fiscal stimulus and demand recovery, have ended up in asset prices be they share prices or housing. We are hearing more frequent anecdotes of labour shortages and rising wages and believe that pressures on companies are such that broader price increases are now likely as the world economy continues to recover. Indeed some large and well known US consumer products companies (including Kimberly-Clark and General Mills) have stated recently that they would start to raise selling prices.



Source: JPMorgan calculations, Bloomberg Finance L.P.

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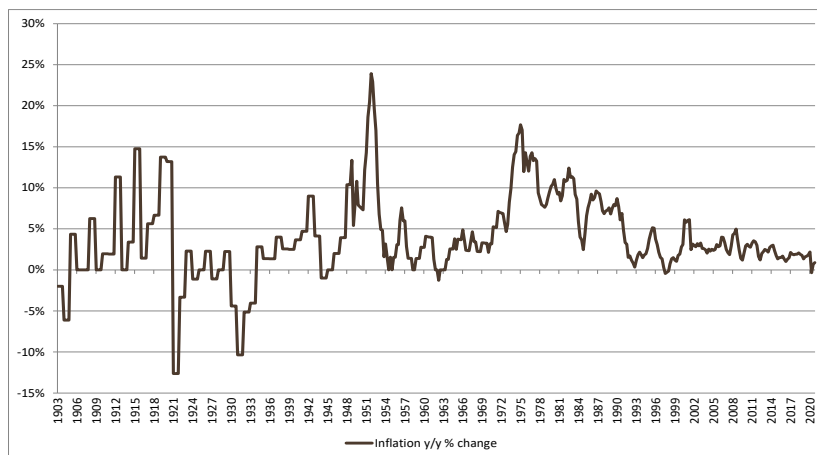
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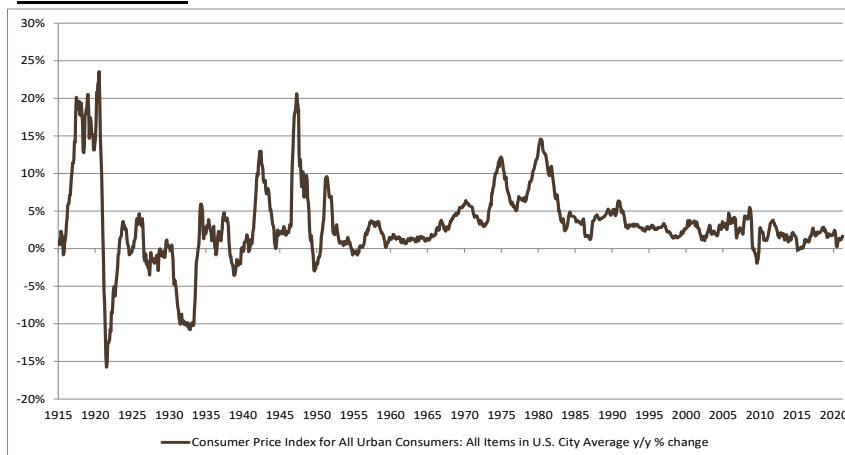
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Australia



Source: UBS

United States



Source: UBS

In Australia we are lucky to be an island able to close its borders and as such have had no real covid virus present in the country for some time. Economically it has not mattered that the roll out of the vaccine has not gone to plan so far, but we will get left behind in the recovery stakes by the likes of the USA and the UK unless things improve on this front. After having botched management of the virus last year, both these latter two countries have turned things around and are well on track to achieving full vaccination in a matter of months. Europe on the other hand is a different story and may act as a handbrake on a full global recovery until governments there truly grasp the vaccine nettle.

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The Portfolio

Orica has been a very disappointing performer for some months now. The company issued an earnings update late in February that resulted in earnings for the 2021 financial year being downgraded by the market. The company's earnings have been under pressure over the last 12 months due to the effects of the pandemic on Orica's customers, particularly in South/Central America, Europe and Africa. This has resulted in lower production levels at mines and thus lower demand for drill & blast products and services. These pandemic related effects have been further exacerbated in the last six months by disruptions in Indonesia (weather related mine disruption), Peru (social unrest disrupting one large mine in particular) and Australia (Chinese coal bans), and increased costs associated with a company wide SAP implementation that has not gone to plan.

We believe most of these issues to be transitory, rather than structural, in nature. Indonesia and Peru are already back or on the way back to normal. In recent months NSW thermal coal exports are back to slightly above last year, even with China still refusing to allow the importation of Australian coal, having found an end-market outside of China. The impact of the pandemic will reduce as the world moves forward with the rollout of the vaccine and/or mine processes adjust to deal with the pandemic risks. The implementation of SAP will take around 18 months and incur additional costs. Our sense at this stage is that the company has its arms around the issue - the system is working, just not yet in an optimal fashion and hence required manual work arounds. Even here the pandemic has had an impact as the level of on the ground training has been below that which would normally be associated with a SAP implementation. That notwithstanding, there has also been an underestimation by the company of the challenges involved. This situation will require monitoring over coming months.

The earnings downgrade came with the announcement of a new CEO in Sanjeev Gandhi. Sanjeev is relatively new to Orica having been the head of the Australia Pacific Asia region for six months. His previous role was in a senior position at the global chemical company BASF, a company he had been with for 26 years. He is very experienced and we see this as a positive move for the company.

We expect a significant improvement in performance as the pandemic abates and mining operations get back to normal. The heightened level of commodity prices is evidence of the improved demand environment and supports a strong return to mining activity. That said, we would not be surprised to see an additional rebasing of earnings when the interim result is released, however we see this as the bottom from a cyclical perspective. Despite all the challenges, Orica continues to improve the business through investment, rationalising operations and implementation of the new enterprise planning software. This will put the business in a position, post-pandemic, to take full advantage of improving end-markets. This opportunity for self-help, combined with the company's investment in technology that has the potential to transform the drill and blast operations of mining companies and improve end-to-end mine process productivity, underpin our investment proposition for Orica.

We exited our long-held position in **ASX** during the quarter. There is no doubting the company's stalwart qualities: it is virtually a monopoly with high margins, stable earnings, a pristine balance sheet and highly capable management. However, after years of consistent mid-single-digit EPS growth, operating trends have turned less favourable recently. This is likely to pressure earnings in the next 18 months. While potential latencies, such as using distributed ledger technology to improve super system efficiency and Sympli to compete against PEXA in e-conveyancing, are conceptually elegant, they are typically either very long-dated (>5 years) or uncertain. Given these concerns around the opportunity set and operating trends, along with a desire to add more cyclical exposure to the portfolio, we saw better risk-adjusted value latency elsewhere.

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We also exited our position in **Aurizon (AZJ)**. We have followed AZJ closely since its IPO and it has been one of the portfolio's core positions for a large part of this period. We re-established a position in AZJ towards the back end of 2018 as we had confidence management would reach a commercial agreement with the miners that would yield a higher return on the network asset, there was latency in the balance sheet, and further cost-out opportunities. We regard both the board and management team very highly, which is reflected in a well-executed strategy in a challenging environment. The turnaround in the bulk business has far exceeded our expectations, but it is a small contributor to the group. Outside of the further efficiency benefits in the above rail coal haulage business, we think the opportunities to grow volume are more limited in the current environment. If the current low interest rate environment persists, the return on the network asset will be reset at a much lower rate in the next regulatory period starting in July 2023, although there will be some offset from lower interest costs. On balance, we decided to sell our position and re-allocate the capital into other areas of the portfolio which hold more opportunity

We added to our position in **Computershare** via participation in the rights issue undertaken by the company to help finance the US\$750mn acquisition of Well Fargo's US Corporate Trust Services (CTS) business.

We believe the deal to be an attractive deal for long horizon investors:

1. Strong strategic fit - Computershare understands this business well - it has a large corporate trust business in Canada, which it has owned for 20 years. CEO, Stuart Irving, has previously described corporate trust as one of the group's two "jewels in the crown" (the other being Registry Maintenance). Corporate Trust is an attractive business because of high entry barriers (need for Federal banking license, high credit rating, service infrastructure) and extreme customer stickiness (once an issuer appoints a trustee, it is very difficult and disruptive to change them). The average mandate lasts close to 10 years, with longer-dated issuances running into 30 years. Computershare launched a US business four years ago and has grown to #8 in the market. However, given the long-dated nature of mandates, it is difficult to achieve material scale organically. This transaction makes it a top four player. The acquisition also increases Computershare's exposure to the long-term structural growth in US bond issuance and securitisation. Both have grown at 7-8% over the last 25 years.

The industry appears to resemble Transfer Agency/Registry Maintenance in the 1990s. At that time, those businesses were non-core operations of large banks and accounting firms, often unloved and sub-economic in their own right. Computershare was the industry consolidator, creating significant scale and attractive economics (high margins/high ROE/high FCF) by buying from strategic sellers.

2. Attractive financial metrics - Computershare has guided to greater than 15% accretion in five years, which includes \$80mn in cost synergies (~20% of the current cost base). Excluding synergies, it is EPS neutral. The long-dated nature of the synergies is not a surprise. Extracting these kind of businesses from large banks (CTS has sat in Wells Fargo for 80 years) is complex and care needs to be taken to manage the transition well. Computershare has a strong history of exceeding expectations with these kind of large transactions (e.g. BNY Mellon Shareowner Services in 2010). Given CTS was such a small part of WFC, it has likely not received the focus it deserves. It will represent almost 20% of Computershare's group revenue, so is sure to get more attention. This creates scope for additional revenue upside by simply executing better. There may also be a real opportunity for revenue synergies given the acquisition will bring ~26k mandates and the clients that come with them.

On an ongoing basis, the business is capital-light and fees are stable and recurring.

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3. Significant rate optionality – Computershare is buying (but not relying on) significant leverage to rising interest rates at the bottom of the cycle.

Having provided information on its corporate structure, and more particularly its infrastructure business, at a strategy day in November last year, **Telstra** confirmed a restructure late in the quarter. The legal restructure is expected to be completed by the end of 2021 thereby paving the way to realising value from both its towers in the second half of 2021 and the balance of its infrastructure assets during the course of 2022. This confirmation, plus a result at which management confirmed its guidance and held the dividend steady, enabled the Telstra share price to rise 15% over the quarter.

It was quite an eventful period for **Seek (SEK)**. The result was above expectations, driven predominantly by a strong recovery in the ANZ job classifieds business. During the quarter SEK also announced a partial sell down of its Chinese jobs classifieds business (Zhaopin), the appointment of Ian Narev to the CEO role and Andrew Bassat transitioning to Executive Chairman and CEO of SEEK Investments, and potentially separating the SEEK Investments business. The price realised from the sell down of Zhaopin to 23.5% on a fully diluted basis was below what we thought the business would be worth if management executed well over the medium term. The sale price partly reflected the current competitive environment where relatively new entrants such as BOSS Zhipin have been gaining market share. Management believe the sell down to a local private equity player who are experienced in the technology investments will add value to its remaining stake over time. On the other hand, we view the appointment of Ian Narev to the CEO role in a positive light as he has executed well in his current role as Group COO and CEO of the Asia Pacific & Americas. It will also allow Andrew Bassat to focus on growing the SEEK Investments portfolio (Early Stage Ventures and Online Education Services) which is where his passion lies. Management are reviewing options on separating SEEK Investments and introducing third party capital. Provided that the portfolio is valued appropriately when third party capital is introduced, we view this positively as it potentially allows SEK to accelerate the growth of the portfolio. It also potentially removes some of the losses from an accounting perspective that are currently reported on a group basis, which makes the current PE multiple look excessively high.

Towards the end of the quarter, **News Corp (NWS)** announced the acquisition of Investor's Business Daily (IBD) for US\$275m and Houghton Mifflin Harcourt Books & Media for US\$349m, all of which will consume about half of the group's cash balance. The acquisitions are in line with the strategy of growing its digital real estate, book publishing, and Dow Jones businesses. The acquisition of IBD will expand Dow Jones' retail exposure and potentially allows it to cross sell IBD products to the Wall Street Journal reader base. Management have executed well in the book publishing business, and the acquisition of Houghton Mifflin Harcourt books will expand its offering of high quality titles. The price paid for the business seems fair and there are cost synergies to be realised. Outside of this, NWS reached deals with Google and Facebook, which will result in payments for access to news from NWS' suite of publications. The benefit will flow through the Dow Jones division and the recently separated News Media segment. Management continue to execute in a positive fashion.

During the quarter, **Lendlease (LLC)** announced Steve McCann will retire as Group CEO effective 31 May 2021 and will be succeeded by Tony Lombardo, currently LLC's CEO of Asia. Steve has had a 16 year career at LLC, including 12 years as CEO, during which he played an instrumental role building out the global development pipeline to more than \$110bn. This project pipeline is made up of twenty-two major urbanisation projects across ten of the world's most iconic gateway cities (including London, New York, San Francisco and Milan). Tony joined LLC in 2007 before being appointed Group CFO in 2011 and CEO of Asia in 2016. LLC's strategy reset outlined in August 2020 is centred around leveraging LLC's competitive advantage in the development and delivery of large-scale, mixed use urbanisation projects and growing the Investments platform, the opportunity around which is substantial (as evidenced by the \$110bn development pipeline). We believe successful execution will result in significant rewards for shareholders, however will require Tony to drive a far greater degree of focus on the core business and intentionality around execution than has been demonstrated historically.

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We headed over to Perth for the first time in about 18 months and met with mining contacts across a range of commodities including iron ore, gold, copper, lithium, mineral sands and rare earths. It's clear that the state has been relatively unscathed by COVID as the elevated commodity prices, in particular iron ore, have been a massive boon for the economy. The days of hopping into a BMW when ordering an Uber are over (for now)! This has also flowed into the housing sector, where house prices are increasing for the first time in a while. The consistent feedback was that, given the increasing level of work across the state and because the borders have been shut, labour shortages are beginning to assert themselves. This is impacting the costs of capital projects across the mining sector, and housing related construction costs. It is expected that this will creep into the operating costs for the miners, if it has not done so already. The high iron ore price is also incentivising the mid-tier miners to consider bringing on additional volume from previously shelved projects.

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