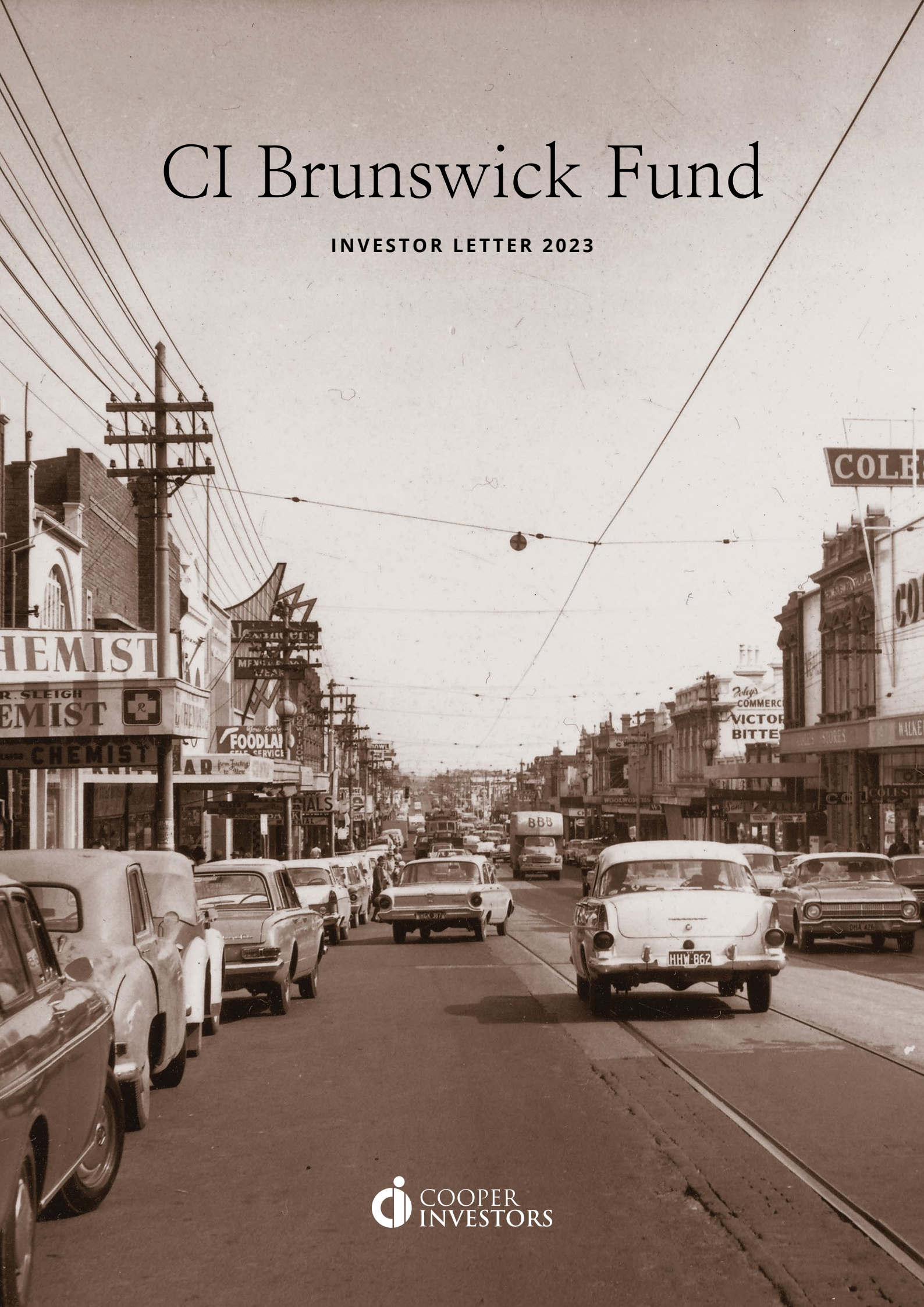


# CI Brunswick Fund

INVESTOR LETTER 2023



## CI BRUNSWICK VS. THE ASX200 ACCUMULATION INDEX

ANNUAL PERCENTAGE RETURN (GROSS)			
	Brunswick Fund	ASX200 Acc. Index	Relative
2023	13.8%	14.8%	-1.0%
2022	-1.1%	-6.5%	5.4%
2021	28.6%	27.8%	0.8%
2020	6.1%	-7.7%	13.8%
2019	5.1%	11.5%	-6.4%
2018	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%
<b>10 Years</b>	13.2%	8.6%	4.6%
<b>Since Inception</b>	1345.6%	358.5%	987.1%
<b>Since Inception (p.a.)</b>	15.1%	8.4%	6.7%

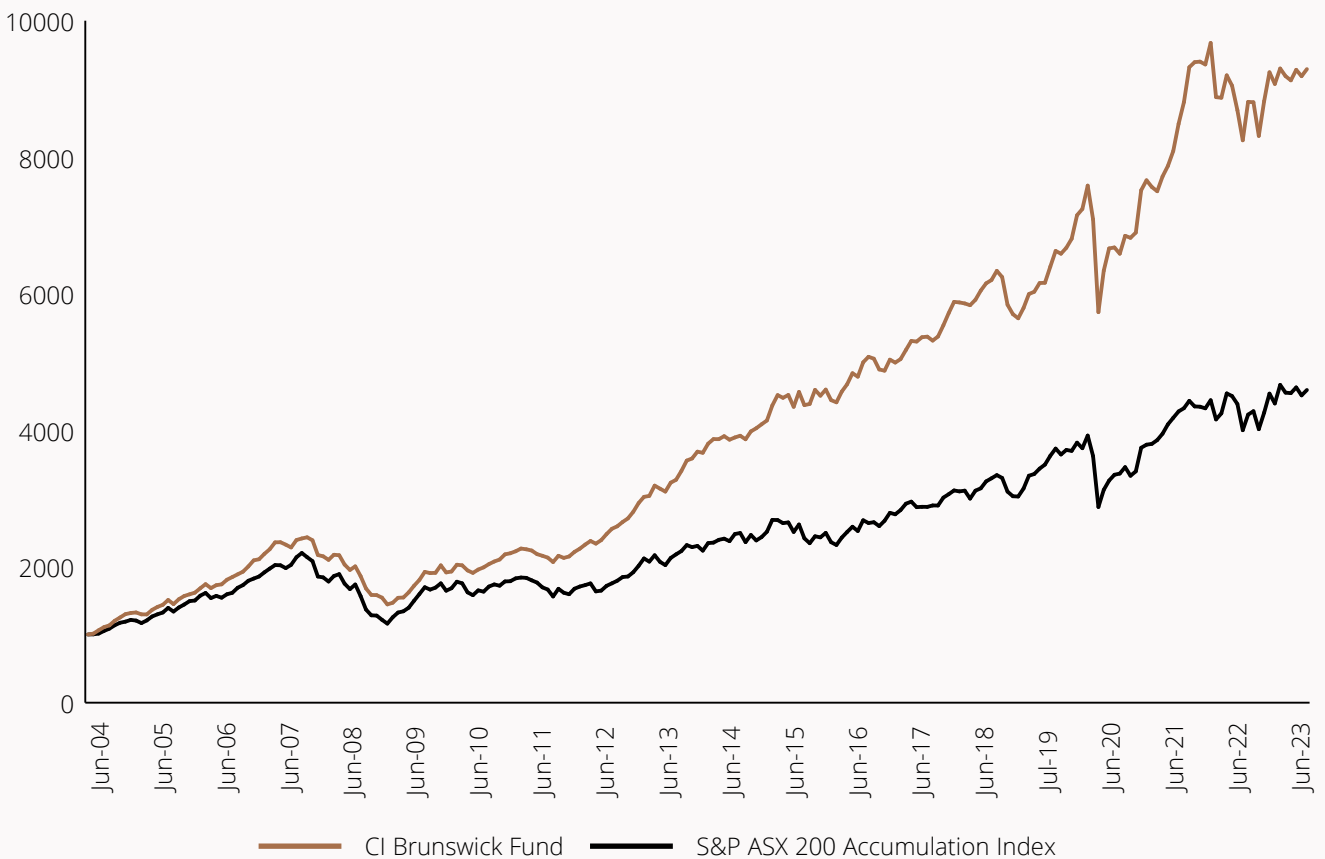
Past performance is not an indicator of future performance

Cover Image: Coburg Historical Society

**BRUNSWICK FUND INVESTORS,**

The end of FY23 marks the 19<sup>th</sup> year of the Brunswick Fund. Over that time, the Fund has returned 15.1% p.a. on a gross or before fees basis, which translates to 9.3x investors’ original investment **after fees** (per Chart 1 and compares to the ASX 200 Accumulation Index return of 8.3% p.a. or 4.6x investment). The more recent experience is a little below the long-term with the Fund’s gross return being just over 13% p.a. over both 3 and 10-year periods [the benchmark returned 11.1% and 8.6% over comparable periods].

**Chart 1 Brunswick Fund Returns Net of Fees (index starts at 1,000 in July 2004)**



Source: NAB Asset Servicing  
 Past performance is not an indicator of future performance

Importantly, our aim is to deliver these returns via a *tortoise* over the hare (consistent, lower volatility/risk) approach. Demonstrating this to you is a little tricky. At the back of this letter there are some statistics that point to the Fund’s below market volatility and the Fund’s attribution which has come from outperforming in down-market conditions.

But another way to think about the Fund’s tortoise-like attributes is through the lens of a ‘batting average’.

A recent article [[Livewiremarkets ASX focus on funds with a better-batting average than Don Bradman](#)] written with the assistance of Morningstar, assessed the consistency of outperformance of a wide set of Australian equity funds covering small and large capitalisation, growth, value and blended styles. The aim was to find which funds had the best batting average for outperformance over the last 15 years.



Taken from the sporting analogy, the batting average idea is closest to the baseball definition which is the number of times a hitter hits the ball per 'time at bat' (i.e., when they are actually swinging at the ball). As such it is a measure of consistency. Morningstar's calculation of batting average is as follows:

*"By dividing the number of rolling periods in which a manager beat or matched an index by the total number of rolling periods within 15 years, for example, Morningstar has been able to measure a manager's ability to consistently beat the market.*

*For example, a manager who meets or outperforms the market in every rolling period during a given time frame would have a batting average of 100. A manager who beats the market in half of these rolling periods would have a batting average of 50."*

The CI Brunswick Fund was listed in this article as one of 18 Australian equity funds with the best 'batting average'. The CI Brunswick Fund had a batting average of 100 – as did nine of the 18 funds referenced.

The Brunswick Fund also had the lowest volatility of all 18 funds [0.6x the most volatile] and ranked 3<sup>rd</sup> over 15 years, 5<sup>th</sup> over 10 years and 6<sup>th</sup> over 5 years for absolute returns [note this calculation was as at the end of April].

Our aim is to try and give you the trifecta ~ good returns, consistently achieved and with lower volatility/risk. We want you to stay with us over the journey, and in particular stay invested when things get hairy.

Underpinning these statistics and throughout the Fund's 19 years, the investment philosophy and strategy has remained steadfast. The Fund is committed to the application of the Cooper Investors VoF investment philosophy across a relatively unconstrained universe.

As has been the case for many years now, the Fund is capacity constrained (currently hard closed), which means we are not taking any more net external applications after accounting for redemptions and cash distributions. This will help us maintain performance while assisting us to take advantage of liquidity events (IPOs, secondary raisings, other dislocations) and quality small and mid-cap stocks.

We thank likeminded investors for your continued support and look forward to finding the best risk adjusted opportunities for the Fund.



**Peter Cooper**

Co-Portfolio Manager  
CIO & Founder



**Justin O'Brien**

Co-Portfolio Manager



**Stuart Mclachlan**

Deputy Portfolio Manager



**Gordon Lee**

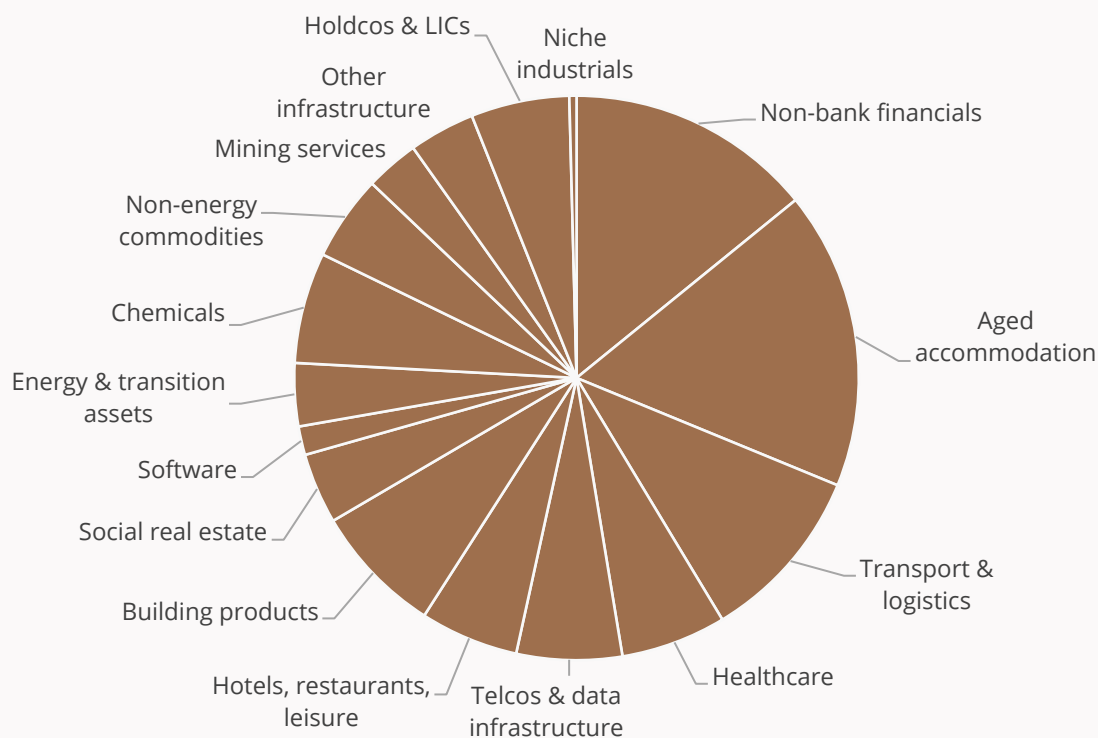
Research Analyst

# What you own

The Brunswick Fund is composed of a relatively eclectic mix of stocks that own businesses operating in a broad array of end markets. However, there are some sectors that feature more prominently – for example the allocation to the aged accommodation sector.

We aim for both diversity (size, geography, business model, subset of value/capital pool) and concentration in key clusters or areas that we think are particularly attractive and where we think our specialist knowledge can add value.

**Chart 2 Brunswick Fund by Sector – A Wide Diversity of Industries**



Source: CI data | As at 30 June 2023

The Fund's benchmark, which is the reference we use for performance, is the ASX200 Accumulation index. In contrast to the above chart, around half of the ASX200 index is represented by a few banks and a handful of large commodity/resource companies.

Although it is an important hurdle for the Fund's performance, the benchmark does not significantly influence the way we manage the Fund and we don't spend a lot of time thinking about how the Fund is positioned relative to the benchmark.

The top 5 holdings in the Fund as at 30th June 2023 in alphabetical order are as follows:

1. Aurizon
2. BHP
3. Brickworks
4. Infratil
5. Ryman Healthcare

# Review of FY23

For the FY23 year the Brunswick Fund returned 13.8%. The ASX 200 Accumulation Index by comparison, returned 14.8%.

In short, the Fund underperformed because we had a couple of particularly poor stocks:

**Table 1** Key Detractors from FY23 Performance

Stock	Portfolio Contribution
Star Entertainment Group	-4.1%
<i>International stock</i>	-1.3%
TPG Telecom	-1.0%

Source: NAB Asset Servicing, CI analysis

We continue to hold two of these stocks – Star and TPG. There is additional discussion on these stocks below.

The International stock was sold during FY23. The stock was bought prior to the rapid increase in interest rates experienced during the last 18 months. Unfortunately, its business model became more challenged as inflation increased (impacting its capital expenditure) and the flexibility in its balance sheet reduced with higher interest rates.

To further assist looking at the Fund's performance, we have cut the portfolio across region (domestic and international) and size (large and small for domestic only). As per last year, we also have more detail on the performance across the Fund's three capital pools.

## PERFORMANCE BY REGION

In the below table we have split the Fund's performance by region. The analysis assumes that each region is held as a 100% portfolio.

**Table 2** Brunswick Fund Gross Returns by Region

Total Returns (p.a.)	FY23	FY22	FY21	FY20	5YR (p.a)
Brunswick Domestic	13.0%	0.3%	30.2%	6.1%	10.7%
Brunswick International	12.8%	-7.9%	27.1%	9.0%	8.4%
<b>Weighted Return</b>	<b>13.0%</b>	<b>-0.9%</b>	<b>29.7%</b>	<b>6.7%</b>	<b>10.3%</b>
Other*	0.8%	-0.2%	-1.1%	-0.6%	-0.1%
<b>Brunswick Fund</b>	<b>13.8%</b>	<b>-1.1%</b>	<b>28.6%</b>	<b>6.1%</b>	<b>10.1%</b>
<b>Index comparisons</b>					
ASX200 Accumulation	14.8%	-6.5%	27.8%	-7.7%	7.2%
MSCI AC World (Net Divs in AUD)	20.4%	-8.0%	27.7%	4.1%	10.4%
<b>Weights (Average)</b>					
Domestic	80.8%	83.3%	82.4%	74.3%	79.3%
International	16.3%	14.0%	14.8%	20.8%	15.6%

Source: NAB Asset Servicing, CI analysis

\*The 'other' line is a balancing item that includes returns on cash, FX impact on cash, FX hedges (FY23 only), and the impact of changes to domestic/international allocation through the period. The 'other' line was stronger in FY23 in part due to gains from a USD FX hedge.

Past performance is not an indicator of future performance

Although there has been variation year on year, the MSCI AC World Accumulation Index (unhedged, dividends in AUD) has performed better than the ASX200 Accumulation Index over the last 5 years [10.4% p.a. vs 7.2% p.a.], particularly during FY23. Clearly, with higher returns in the domestic part of the Fund, we have done a better job picking stocks in the domestic market.

It's worth noting that the above analysis is akin to assuming a highly concentrated (typically 3-7 stocks) stand-alone international strategy. In practice the Fund's international stocks are much more integrated in the portfolio, selected to play a particular role across capital pools.

The Fund's exposure to International stocks is now low versus history at 8% as a couple of positions were recently sold.

However, we continue to believe there is value in having an allocation to International stocks. There are numerous examples over the past 10 years where we have been able to optimise the portfolio by comparing domestic versus international opportunities. For example, we have invested in both Xero and Intuit (both cloud accounting software providers), Reece and Ferguson (both plumbing distributors), Brookfield, Macquarie and Infratil (investors in Infrastructure and related private assets), Ferrovial, Transurban and Auckland Airport (infrastructure owners). And there are many more examples.

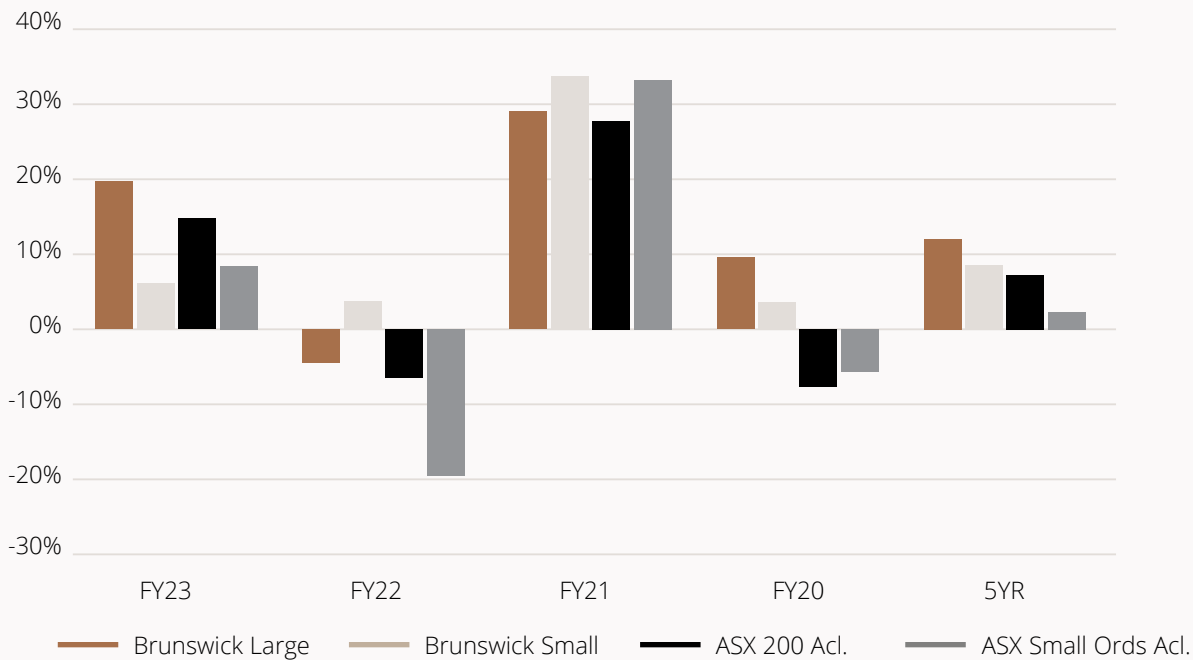
This ability to compare and contrast deepens our knowledge of particular business models, allows us to cluster our investments (i.e., buy both stocks if the opportunities are both attractive), or select the stock that appears most attractive for the Fund at a point in time.

## PERFORMANCE BY SIZE

Also worth noting is the variation in returns when a size (market capitalisation) lens is applied to domestic stocks. More broadly across the market, small capitalisation stocks have struggled relative to their larger counterparts over the past 5 years. As highlighted in the chart below, despite outperforming large cap stocks in FY21 as markets more broadly gained following re-opening post covid-19, the subsequent rate rises that started midway during FY22 had a more significant impact on the share prices of smaller companies. The result is the Small Ordinaries Index has returned only 2.3% p.a. over the past 5 years, significantly underperforming the ASX200 return of 7.2% p.a. This phenomenon is not isolated to Australia – the Wall Street Journal recently reported that *“the Russell 2000 has lagged behind larger stocks by more than 7 percentage points annually over the past five years... that underperformance is among the worst relative five-year returns since 1926.”*

Across the same period, the Brunswick Fund's smaller stocks were relatively more stable having kept up in FY21 and delivering a small gain in FY22. However, FY23 has been disappointing with the Fund's stocks trailing the small cap index, and more significantly underperforming the ASX200. Although it's important to note the cross-over with the contribution of Star Entertainment, which is also a small capitalisation stock.

**Chart 3 Brunswick Fund Gross Returns by Size**



Source: NAB Asset Servicing, CI analysis  
Past performance is not an indicator of future performance

This is shown in more detail in the table below, which includes the weightings to small and large capitalisation stocks over the past 5 years.

**Table 3 Brunswick Fund Gross Returns by Size**

Returns (p.a.)	FY23	FY22	FY21	FY20	5YR
Brunswick Large	19.7%	-4.4%	29.0%	9.6%	12.0%
Brunswick Small	6.2%	3.8%	33.7%	3.6%	8.5%
<b>Weighted Returns</b>	<b>13.5%</b>	<b>-0.8%</b>	<b>30.9%</b>	<b>6.6%</b>	<b>10.3%</b>
Other	-0.5%	1.1%	-0.7%	-0.5%	0.3%
<b>Brunswick Domestic</b>	<b>13.0%</b>	<b>0.3%</b>	<b>30.2%</b>	<b>6.1%</b>	<b>10.7%</b>
<b>Index Comparison</b>					
ASX 200 Accumulation	14.8%	-6.5%	27.8%	-7.7%	7.2%
ASX Small Ords Acl.	8.4%	-19.5%	33.2%	-5.7%	2.3%
<b>Weights (Average)</b>					
Domestic large	42.9%	46.3%	48.9%	37.9%	41.8%
Domestic small	37.9%	37.0%	33.5%	36.4%	37.5%

Source: NAB Asset Servicing, CI analysis  
Past performance is not an indicator of future performance

Similar to the observations about international stocks, over the longer-term smaller capitalisation stocks have added significantly to the Fund's performance. We expect going forward that small capitalisation stocks will once again provide a strong tailwind for the Fund.



# Capital pools

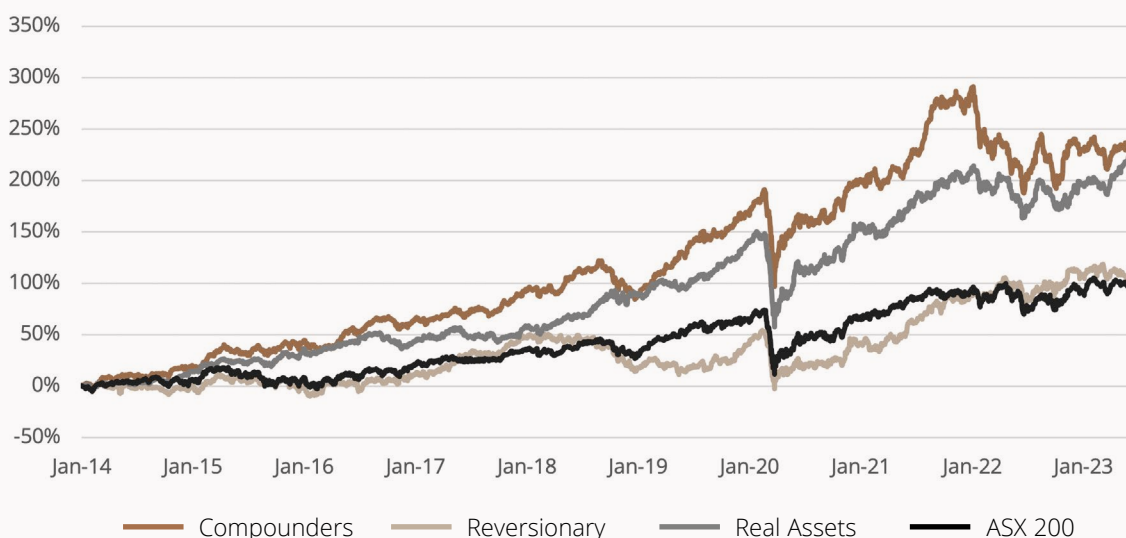
The portfolio stocks can be grouped into three key areas or capital pools:

Compounders	Reversionary	Real Assets & Income
<i>Growth + Stalwarts</i>	<i>Cyclicals + Low-risk turnarounds</i>	<i>Bond-like equities + Asset plays</i>
UNDERAPPRECIATED GROWTH	LOW RISK SOURCES OF REVERSIONARY VALUE	UNCORRELATED, ENDOWMENT-LIKE ASSETS
<ul style="list-style-type: none"> <li>Runway for organic growth</li> <li>Proprietorial managers (family's and founders and owner-operator cultures)</li> <li>Pathway of value creation</li> <li>Identifiable value based on traditional metrics</li> </ul>	<ul style="list-style-type: none"> <li>Quality businesses</li> <li>Defensive sectors</li> <li>Capital or supply scarcity</li> <li>Balance sheet repair</li> <li>Corporate events (spin-offs, restructurings etc)</li> <li>Specific pathway for value creation (eg cost out)</li> <li>Specialist (expert), aligned management teams</li> </ul>	<ul style="list-style-type: none"> <li>Asset backing</li> <li>Lower correlation to markets</li> <li>Inflation protection (income or assets)</li> <li>Ability to grow asset value over time</li> <li>Evidence of valuation anomalies</li> </ul>

We've captured data on the three pools over the last 10 years of the Fund. The chart below assumes each pool is a separate portfolio. Of note, the real asset and income pool has produced particularly attractive returns over the period given it has the lowest volatility.

While the reversionary pool returns are lowest over the full period, the capital pool has delivered strong returns over the last few years. In part, this reflected opportunities created as a result of covid-19 and more recently the increasing interest rate cycle. We have also spent more time focusing on this pool to improve our ability to source low risk opportunities – but as the FY23 year showed, this remains a work in progress.

**Chart 4 Brunswick Fund Cumulative Gross Returns by Capital Pool**



Source: NAB Asset Servicing, CI analysis

We've also compiled the returns of each capital pool on an annual basis, as well as the annualised volatility of each pool.

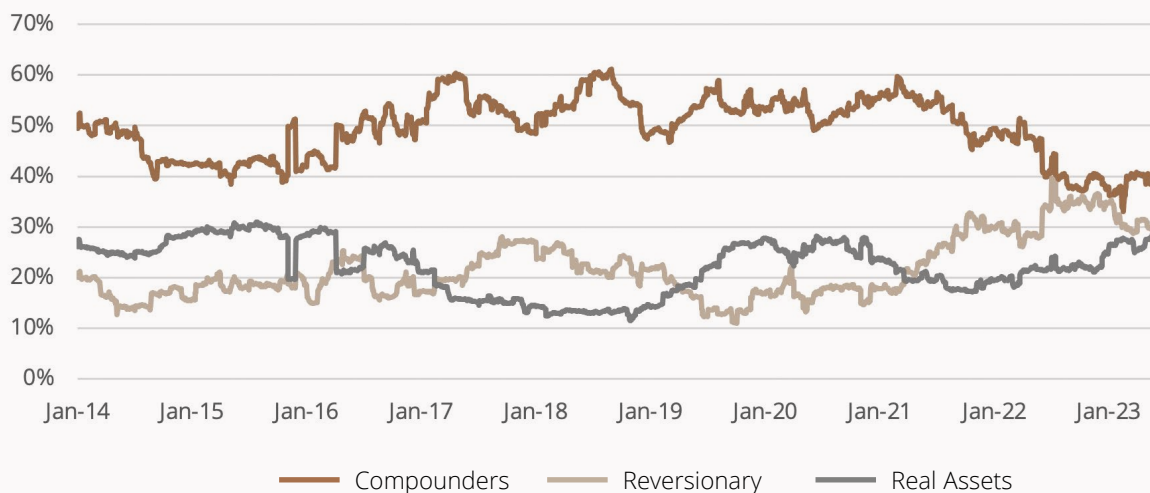
**Table 4** Brunswick Fund Annual Returns by Capital Pool

Financial year (ending 30th June)	Compounders	Reversionary	Real Assets
2014*	9.9%	-2.2%	2.6%
2015	18.3%	6.0%	18.6%
2016	18.0%	-5.2%	21.1%
2017	12.7%	34.3%	0.4%
2018	21.8%	9.5%	14.0%
2019	13.5%	-18.3%	20.0%
2020	10.1%	0.9%	4.5%
2021	25.3%	35.9%	34.2%
2022	-8.9%	14.9%	-4.8%
2023	13.7%	7.7%	20.1%
Return (Ann.)	13.8%	7.6%	13.2%
Volatility	12.7%	16.2%	12.1%
ASX 200 (Ann.)	7.5%	7.5%	7.5%

Source: NAB Asset Servicing, CI analysis  
 \* 2014 excludes 1H

Below we show the allocations across the three pools. More recently, the most attractive area has been in real asset and income securities, which is now more than 30% of the portfolio. We expect this pool will fare relatively well in most economic conditions.

**Chart 5** Brunswick Fund Capital Pool Allocation



Source: NAB Asset Servicing, CI analysis

# Key Contributors for the Year – Stock level

## **ELMO SOFTWARE (ELO)**

Elmo Software was subject to a takeover offer during the year.

Elmo provides cloud-based HR software in Australia and the UK to a mix of SME and mid-market customers. The Fund held Elmo for around 5 years since its IPO in the middle of 2017 and for most of that period the weighting in the Brunswick Fund was relatively small. Since IPO, Elmo has grown its annual recurring revenue by around 30% p.a. and made a series of acquisitions to assist building out its product set.

Elmo's share price fell to a low of around \$2.20 per share in June 2022, when a large UK holder opted to sell at depressed prices. At this stage the Brunswick Fund more than doubled its position, holding ~8% of the register.

Not long after this, we travelled to the UK and visited Elmo's two UK businesses – Webexpenses, which offers cloud-based expense management software (receipt management and reimbursement) and Breathe, which offers HR software to SMEs. We also met with a number of customers, former employees and industry consultants to deepen our knowledge, reaffirming both the quality of these businesses and what appeared to be a significant opportunity in the UK.

Shortly after returning from the UK, Elmo received a binding takeover bid at \$4.85 per share from K1 Investment, a US-based private equity fund that specializes in the software sector and it seems likely Elmo's UK businesses were a key attraction for K1. Despite the takeover bid being below our view of longer-term value, our IRR was ~12% p.a. over the 5-year investment period (vs ~7.2% p.a. for the ASX200 Accumulation Index and ~2.3% p.a. for the ASX Small Ordinaries).

## **NEW HOPE (NHC)**

New Hope was the strongest contributor to Fund performance over the past few years. The stock was sold during FY23 as thermal coal prices peaked. The investment generated an IRR of ~46% p.a. over the past 3.5 years.

Our top-down observation post significant work was that thermal coal was likely to be a required baseload power source for the developing world for at least the next few decades. We also observed extremely limited new thermal coal supply and exceptionally low capex being spent on existing mines. Effectively resilient demand paired with declining supply.

Importantly, New Hope provided us with an attractive risk-adjusted bottom-up exposure to express this positive top-down perspective. The company is ~40% owned by Washington Soul Pattinson (SOL), one of our capital allocation champions with Rob Millner as the Chairman of both companies. New Hope owns and operates the Bengalla Coal mine in NSW, which is in the bottom quartile on the seaborne cost curve and they also own the New Acland 3 coal mine which is currently ramping up post receiving approvals to re-start mining post a two year hiatus.

We acquired our position as the thermal coal price went below the 90th percentile of the cost curve (i.e. 10% of the industry began losing money) and the company was trading below the capital it had invested. We progressively added to it over time as industry pain intensified and New Hope's relative positioning improved. As we observed improving operating trends for New Hope in particular with regards to FCF generation and strong operational performance with little follow through into New Hope's share price we added further to our position.

While the share price had more than doubled from its lows prior to Russia's invasion of Ukraine, it outperformed significantly in the year following given Russia is a major exporter of high-quality thermal coal (i.e. directly competing supply was constrained).

We exited the investment earlier this year as our interactions with industry participants indicated softening operating trends with growing downside risks for the thermal coal price from an extremely elevated level. In addition, the value latency wasn't sufficient to offset this softening trend.

## INFRATIL (IFT)

Infratil (IFT) sits within our Real Assets & Income capital pool and has demonstrated a long history of superior capital allocation (18% TSR over 20 years). The Brunswick Fund has owned Infratil for 4 years and the stock continues to offer investors an attractive exposure to a few key areas of infrastructure asset growth, in particular:

- **Renewables:** Infratil has exposure to one of the leading developers of renewables assets in the US – Longroad Energy (37% ownership). Longroad has 30 owned projects totalling 2.4GW, predominantly solar projects and an 18GW pipeline, supported by a team of 160 people. The opportunity in the US has accelerated following the recent introduction of the Inflation Reduction Act, which provides additional subsidies for development of renewable assets. In addition to Longroad, Infratil's European based Galileo has a 9.4GW pipeline and Gurin Energy based in Asia has a 2.8GW pipeline.
- **Data Infrastructure:** Infratil owns 48% of Canberra Data Centres (“CDC”), which is one of Australia’s leading developers of data centres, particularly to a range of government clients. Infratil also wholly owns OneNZ (formerly Vodafone NZ), the second largest integrated telco in New Zealand.

Infratil has a unique balance of cash generating and development assets which provides investors with an attractive mix of return and long-term growth. Infratil's platform based approach has created significant risk-adjusted value latency which hasn't been obvious when looking at headline valuation metrics. This is underscored by the current situation where their portfolio has a high level of organic capital deployment opportunities (i.e. new data centres requested by existing customers). These returns continue to appear attractive while the incremental risk profile is lower as the “platform” (people, systems, IP, network et al.) is already established. A vital ingredient is Infratil's approach in partnering with the business' founders and key executives to ensure both the right people and right incentive structures are in place to deliver this low risk investment.

Infratil's key mantra is pursuing “ideas that matter” and what we have come to appreciate is their ability to fully capitalize on these ideas once they have been de-risked and “proved up”. This can be seen in their highly successful ownership of Tilt Renewables in Australia which then led them to invest in Longroad, which has generated even higher returns than Tilt. Consistent with fully capitalizing on these “ideas that matter” where they have built genuine internal IP such as in Renewables development, they have also since created separate businesses in Europe, Asia and now Australia (again post sale of Tilt).

## BRICKWORKS (BKW)

In a similar vein our investment in Brickworks (BKW), an asset play, provides us with low correlated asset exposures. This primarily comprises 1) a significant look through exposure to Washington Soul Pattinson's defensive portfolio of listed and unlisted assets, 2) a leading Australian focused Industrial REIT with embedded growth options and 3) leading building materials businesses in Australia and the US.

The important feature of our investment in Brickworks is not only that the stock is trading at a discount to our ‘sum of the parts’ valuation (which is \$35-38/share vs a ~\$26 share price at present) but also that Brickworks ‘parts’ are growing in value and the highest growth is occurring in the highest quality assets – for example the Industrial REIT which comprises more than 30% of our valuation today. This mix shift in portfolio quality over the past 5 years remains under-appreciated in our view.

In addition, the ~20% of the NAV which relates to the building materials business (Australia and US) also remains well under the radar. In Q4 we spent two weeks in the US, with the first week focused on homebuilders and building products, while the second week was a detailed site visit across Brickworks many US manufacturing plants and distribution sites.

The US opportunity appears attractive longer-term with the industry heavily under-invested in since the GFC, with consolidation and closures dominating such that Brickworks has acquired assets at well below replacement value (albeit cum capex). We also visited Acme brick, owned by Berkshire Hathaway, the largest Brick manufacturer and Distributor in the US (although in mostly different markets to Brickworks) who spoke to a similar need to improve industry economics.

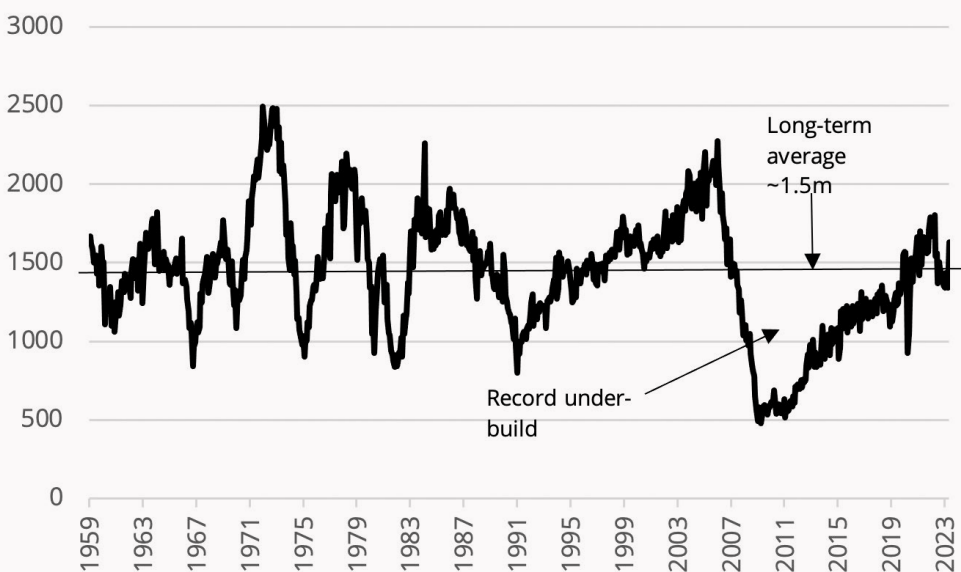
There is significant scope to optimize the US assets with brick production per person still more than 2x higher versus Australia. There is also an opportunity to monetize half of their initial investment via an Industrial REIT site with Goodman given one of their assets has large vacant land in a potentially attractive site.

However, the highest value latency is likely to come from taking control of more of the value chain and extracting a distribution margin from their products and their competitors, which is where most of the industry value seems to reside. Brickworks more recently acquired an existing distribution business (~\$50m Enterprise Value, more than 25% ROCE) which will be their blueprint for expanding their distribution footprint.

The broader context of our first week of meetings supported the opportunity for Brickworks and more broadly for companies exposed to the US building cycle. The Homebuilders that we met were all confident with surprisingly resilient demand and positive (short-term) lead indicators. This seems to partly reflect years of under-build, low turnover in existing housing stock (people locked in at low rates), finance incentives for new builds cushioning the rate impact (average mortgage payments up ~30% versus 100% implied by the move in 30-year mortgage rates) and the trend to the South where the large listed homebuilders are focused.

At present, the US has only just recovered back to the long-term average housing starts of ~1.5m p.a. The significant under-build post the GFC, should support any weakness shorter term and points to likely strength over the medium-term, particularly if turnover of existing housing stock remains low.

**Chart 6 US Housing Starts ('000)**



Source: St Louis Fed Economic Data



# Key Detractors for the Year – Stock level

## STAR ENTERTAINMENT (SGR)

Our biggest detractor by far during the year was Star Entertainment (SGR), a Reversionary investment.

We entered into the investment while Star was in the cross-hairs of the regulators, had significantly under-performed, and channel checks had indicated Star's governance, controls and processes were better than Crown's. As it turned out, Star was at best no better than Crown, but in some respects likely worse (if number of infringements is the metric used to judge).

Analogous to an iceberg, the visible issues were only a small part of what unfolded, which then compounded on one another. For example, Star's loss of its 'social license' following the revelations of its breaches meant it became an easy target for State Governments to increase tax rates at the same time it was also facing operating challenges and unknown liabilities (such as fines).

It is likely we would have fully exited the position had it not been for the entry of the Mathieson family to the register, with the expectation they are unlikely to be passive given their 10% holding.

We still perceive Star to be trading at a significant discount to many forms of normalized value, which should be realisable over a 5 year investment horizon. Star owns 50+ year monopolistic assets with resilient demand profiles, high and increasing barriers to entry, is leveraged to strong inbound tourism and population growth and trades well below replacement value.

Star's current market capitalisation is ~\$1.6bn (Enterprise Value of ~\$2.1bn including debt, but noting this excludes liabilities for future fines). Below are some reference points for the value latency argument:

- Star's Hotels alone have a ~\$800m estimated market value (excluding Sheraton Mirage which is being sold for ~\$192m).
- Electronic Gaming Machine (EGM) transactions imply a value north of \$2bn on the machines alone.
- Star now trades at a >30% discount to invested tangible capital and a 75% discount to historical trading multiples based on invested tangible capital.
- Star trades at a significant discount to replacement value (Queens Wharf Brisbane estimated at >30% discount to invested capital already).
- Current expected ROFE (return on funds employed) in FY25 of 4% is extremely low but still equates to Star trading on a ~9% free cash flow (FCF) yield, which is attractive for an asset backed business. Casinos globally have typically oscillated between 8-20% ROFE and Star averages ~15% over the past decade. Therefore, even though Star is significantly under-earning in the near term, it is still generating a strong underlying FCF yield reflecting significant share price declines.
- Blackstone cost synergies from an acquisition are conservatively 75% of the current market capitalisation. Synergies from optimising the two Sydney casinos is likely significant albeit difficult to quantify as an outsider.
- There are now more than \$1bn in deferred tax assets.

This value latency argument is contrasted against our risk adjustments – what we call "OI&F" – operating, industry and strategic trends and focused management behaviour. On these metrics Star looks relatively challenged (although with some signs that things are improving):

- Star's near term earnings remain under pressure from NSW taxes, cost inflation and the impact of Crown Sydney.
- Regulators are still running Star's casinos, which means operations are unlikely to be optimised near term.
- Management and Board have been replaced and lack real casino experience.
- The balance sheet remains under pressure given the fall in earnings, and future unknown liabilities.
- Brisbane (QWB) project is meant to come on-line in April 2024. There is risk this doesn't go as planned, particularly given recent turnover in management.

While we have a reduced position in Star, we are focused on remaining agile and open-minded (either way).

## **TPG GROUP (TPG)**

TPG Group underperformed mainly due to the ACCC's decision to deny the proposed network sharing agreement with Telstra (subsequently upheld by the Australian Competition Tribunal). The agreement would have seen Telstra provide TPG access to its rural mobile network in exchange for transferring some of TPG's unused spectrum. It was expected this would assist both TPG and Telstra at Optus' disadvantage. Without this agreement it is possible TPG is forced to spend more on capital expenditure on its rural network, or seek a less value-enhancing agreement, for example with Optus.

TPG trades on a lower multiple (EV/EBITDA) relative to Telstra and Spark (New Zealand). Given an improving industry structure (higher prices), recovery of roaming, tourism and migration related subscriber growth, we expect TPG has a solid pathway for growth in EBITDA and free cash flow in coming years.

## **RYMAN HEALTHCARE (RYM)**

Ryman is a specialised developer and operator of mixed retirement villages incorporating independent living units and aged care accommodation in both Australia and New Zealand. Ryman was founded in Christchurch in 1984 by John Ryder and Kevin Hickman, and by 1996 had opened its first 'continuum of care' village in Invercargill. The 'continuum of care' concept, where residents are able to move from independent living units to serviced apartments and finally aged care and dementia wards, has since become the industry standard in the New Zealand market. More recently Ryman has taken this model to Australia, focusing on Victoria.

Ryman also pioneered a unique 'capital recycling' commercial model. Having raised equity at its IPO, Ryman's approach was to recover every \$ of capital deployed into a new village via the sale price of its units. In theory, Ryman would be able to grow without additional equity capital.

Remarkably Ryman did this while growing unit volumes by 10-15% p.a. for many years. Unlike a traditional developer, Ryman never truly sells its product to residents. Rather it sells a right to occupy, buying back when the resident leaves. Ryman receives 20% of the original purchase price and any capital gains as its fees. Ryman can then repeat this process many times, albeit with the need to periodically refurbish the units to ensure they remain attractive to new residents.

This worked very well for the first 15-20 years. However, Ryman's strategy then evolved to favour larger more high-rise developments over broad-acre developments. High-rise developments require significantly more capital up front and take longer to recycle capital as a greater portion of the building needs to be finished before cash is recovered via unit sales.

As Ryman had also been using debt, this led to a significant increase in gearing more recently.

In addition, the backdrop for government funding of the 'care' component of the model started coming under pressure. This was exacerbated by covid-19 – costs increased, it became more difficult to find and retain staff, and government funding remained woefully behind. Finally, the rapid increase in interest rates, falling house prices and increases in construction costs raised concern about the sustainability of Ryman's profits and whether its debt covenants would be breached.

In the end, Ryman made the decision to raise equity for the first time in 25 years, which reduced gearing from 45% to 32%. The Fund participated in this equity raising. Ryman also elected to slow some of its more capital-intensive developments.

The obvious question is why have we 'stuck it out' with Ryman. Up until 2019, Ryman's compounding characteristics were very attractive – as shown in the table below. Even including the recent poor period, Ryman has been a very good compounder.

**Table 5** Ryman Compounding Characteristics

	IPO to 2019 (p.a.)	Last 4 years (p.a.)	Since IPO (p.a.)
<b>Share price</b>	22.1%	-12%	14.5%
<b>Dividends</b>	3.1%	1.6%	2.7%
<b>Total return</b>	25.2%	-10.4%	17.2%
<b>Volume (units)</b>	12%	6.5%	11%
<b>EPS</b>	16.4%	7.3%	14.8%
<b>NTA/share</b>	9.3%	11.3%	9.7%

Data source: Factset, company disclosures, CI analysis  
 Past performance is not an indicator of future performance

During the recent weakness, Ryman has continued to deliver units and grow its asset base. The need for Ryman's offering has grown given its core demographic group of 80+ year olds is growing at a multiple of population growth. Ryman has 16 development sites in various stages of completion versus just 4-5 a few years ago. Based on the existing development pipeline we expect Net Tangible Assets per share (NTA/share) to nearly double over the next 5 years.

At present Ryman's share price trades close to its NTA/share. In contrast, through most of its history Ryman traded at 2.5x NTA (average). It is hard to buy quality compounders at reasonable prices. It is even harder to buy them cheaply. In most cases you need something to have gone wrong either with the business or the industry.

Because of its founder-led history, Ryman sits in our 'owner-operator culture' category of management. However, Ryman's recent poor performance does not reflect well on management and directors. On a positive note there are a number of long-term shareholders working behind the scenes to turn things around. Reflecting this, Ryman recently appointed a number of new Directors including a new Chairman, who has a much stronger commercial background.

# New Stocks – Aurizon (AZJ)

Every year there are a few opportunities that appear with relatively asymmetric profiles – attractive upside risk with minimal downside risk. Aurizon was one of those situations in FY23.

Aurizon is Australia's largest railroad business. It owns the rail network/track in Queensland that is used to haul coal from mine to port (70% metallurgical coal, 30% thermal coal). It is also a haulage operator for coal across both Queensland and NSW markets. Finally, Aurizon has a growing bulk business where it hauls grain, rare earths, iron ore, copper concentrates, bauxite, nickel, phosphates, and more recently containerised general freight for freight forwarders like TGE (the old Toll Express).

After its first half result (presented in February), Aurizon's shares fell by more than 15% when the company delivered a lower than expected profit result, as poor weather (rain) resulted in reduced coal volumes. However, this impact on profit is temporary with volumes expected to fully recover going forward. In most instances, temporary impacts on profitability wouldn't see this degree of share price impact. This reaction likely reflected investor 'angst' to the many challenges Aurizon has faced in recent years given exposure to coal and more recently capital deployed to transition away from coal.

The Fund bought its position shortly after the result. At that point Aurizon was trading on a 12-13x PE ratio. At a headline level, this is a low rating given Aurizon is an infrastructure-like business. But it is important to note that valuing Aurizon's infrastructure (track network in Queensland) is not a straightforward task. As a regulated asset, comparable companies include Dalrymple Bay Coal Terminal which while recently deregulated (allowing it to charge higher prices), is still the most comparable listed company given the similarity of take-or-pay contract structures and customer base (80% metallurgical coal, 20% thermal coal exporters). Dalrymple Bay currently trades well over 1.3x its asset base and has rarely traded at less than 1.1x asset base. If we were to apply this 1.3x multiple to Aurizon, then the market is ascribing very little value to the rest of Aurizon's business.

Regardless of how we value the stock, Aurizon appears 'cheap' relative to comparable infrastructure assets and offshore listed railroad peers. However, value latency is rarely enough. Our VoF framework also requires positive operating, industry and strategic trends, and focused management behaviour. Comparable peers in the US have earned a premium multiple by delivering many years of earnings growth, interestingly via only minimal volume growth – typically 1-2% p.a. Pricing and mix benefits have turned this 1-2% volume growth to 5-7% p.a. revenue growth, and with margin and capital efficiency savings 15-20% EPS growth p.a.

On closer inspection post its half year result, it was clear to us that FY23 will be the trough year for earnings for Aurizon and there are a number of reasons why earnings should grow solidly in coming years, including:

- A recovery in weather related coal volumes
- Continued demand growth for high quality met coal globally (particularly India)
- CPI linked coal contracts above cost inflation
- Ongoing efficiency savings via outsourcing, head office and implementation of 'trainguard'
- A significant upward reset of the WACC for the regulated track revenue
- New contract wins in Bulk

Should Aurizon achieve some growth in earnings, it will be a significant change given the company has struggled to grow in recent years.

We also view industry structure as positive. Aurizon is the scale player while key peer Pacific National, under private equity ownership, appears more highly geared and with a history of under-investing in the containerised segment and more recently gouging its customers (due to its perceived monopoly position in the segment).

Lastly, we rate the management team and Board highly. We have followed the team closely for many years and previously invested in the stock. They sit in the 'specialist focused manager' category of management teams.

# Shorter-term opportunities

Since the onset of the interest rate increase cycle of the past 18 months, there has been significantly fewer IPOs and capital raising. However, during FY23 there were a couple of opportunities for the Fund. Firstly, we saw a short-term opportunity to invest in quality, large Asian stocks with significant value latency. We took a position in Tencent (700-HK), the ~US\$400billion diversified technology company (gaming, fintech) when it was trading at ~12-13 PE ratio (adjusting for all of its investments). However, the stock quickly rerated and it was sold.

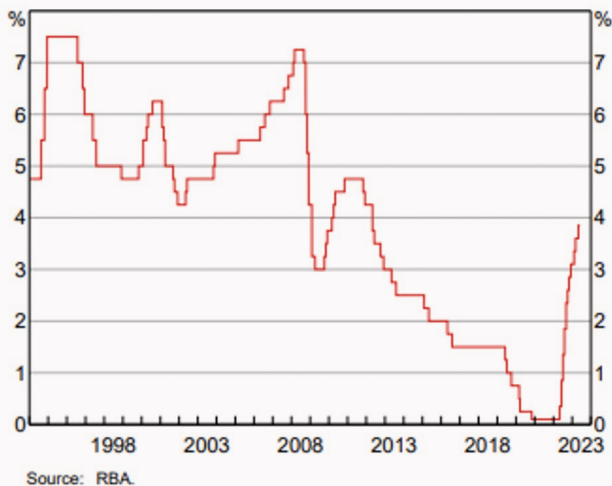
Secondly, the Fund made a gain on fixing half of its USD exposure when the AUD was at 63c (bottom decile vs history). This was closed out (3 months later) following a recovery in the AUD.



# Market Context

In recent years, a volatile 'top-down' or macroeconomic backdrop has been the norm for the stock market. On the one hand the current rate rise cycle has no precedent with respect to the magnitude of the increase, although the increase has come off a very low base.

**Chart 7 Australian Cash Target Rate**



Source: Reserve Bank of Australia

Australia's mostly variable mortgage market means we are well ahead of most other countries in terms of the impact on the economy. The change in interest payments is significant for most borrowers and is feeding through the Australian economy most pointedly via reduced discretionary spending.

However, Australia has offsets. Demand for future facing commodities should support parts of the Australian economy, particularly in Western Australia. In addition, Australia remains an attractive place to live given high standards of living and wealth per capita relative to the rest of the world, with migration levels expected to remain high in coming years. Both Federal and State governments embarked on many infrastructure projects, even pre-dating covid-19, but which accelerated as part of fiscal stimulus response. Although this has added materially to government debt levels, the Nations' balance sheets are still better placed than many countries around the world.

Some of these factors explain why despite a material correction in house prices, the trend has again turned positive. In addition, the inflationary impact on new builds and supply /demand imbalance also appears to be flowing through rents:

**Table 6** Changes in Residential Asking Prices and Rents (as at 20th June 2023)

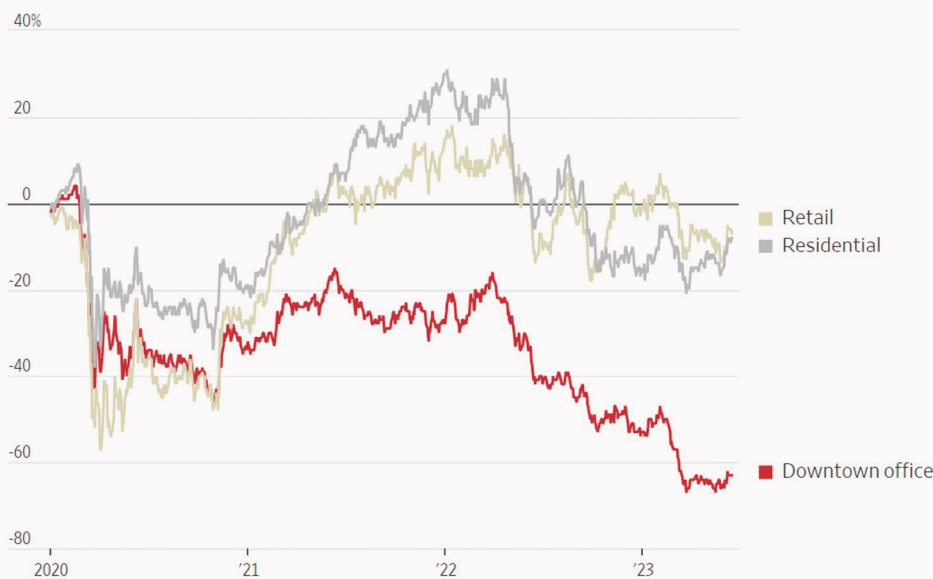
12 month % change	Asking Prices		Asking Rents	
	Houses	Apartments	Houses	Apartments
<b>Sydney</b>	5.6%	8.1%	17.9%	25.7%
<b>Melbourne</b>	1.1%	0.9%	19.1%	21.8%
<b>Brisbane</b>	3.5%	16.2%	10.5%	23.2%
<b>Perth</b>	9.8%	9.2%	17.2%	20.5%
<b>Adelaide</b>	8.0%	21.6%	11.6%	13.0%
<b>Capital City Average</b>	4.8%	7.6%	15.3%	22.5%

Source: SQM Research, Weekly Asking Prices Index

Given no sign these trends are slowing – if anything demand (via migration) is likely to continue to outstrip supply, it seems likely that ‘assets in place’ remain highly valuable, particularly property exposures like residential, social and industrial given the impact of inflation on capex and replacement assets. It also re-emphasizes that companies that can deliver affordable housing product to the market at present are likely to be very well-placed.

We remain cautious that mortgage arrears are likely to rise as are corporate defaults. The large Australian banks have mostly avoided a default cycle for many years, so there is risk of surprises in areas that are not well understood. One such area is commercial real estate which has been significantly impacted by changes in demand (work from home), as well as being sensitive to interest rates in terms of valuation of assets and gearing levels. The chart below illustrates the dramatic divergence across real estate sectors in the US.

**Chart 8** Average Change in Share Price of Five Largest US REITS, by Sector:



Note: Change since the end of 2019

Source: Wall Street Journal

# Current Fund Positioning

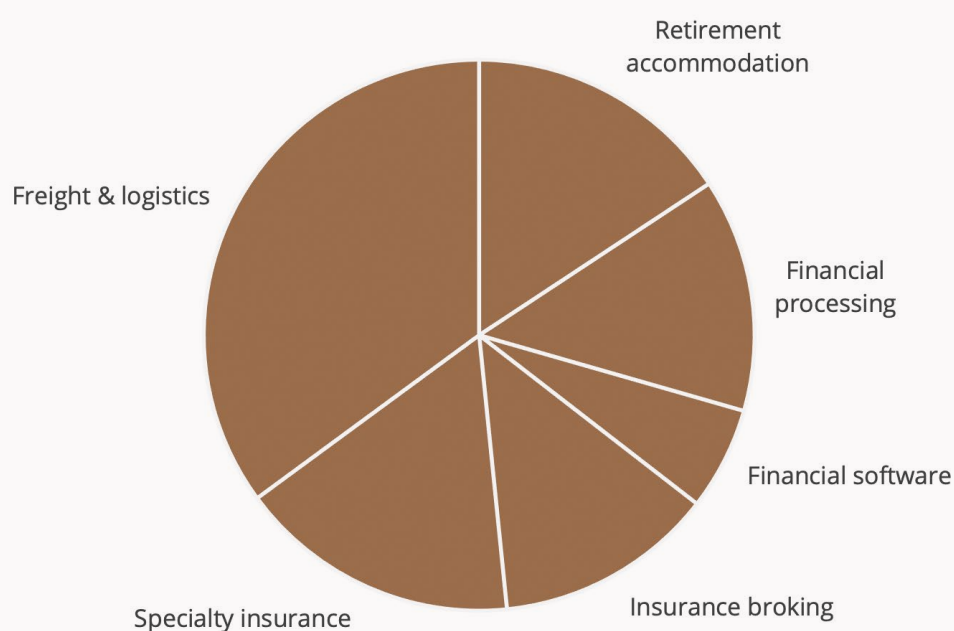
## COMPOUNDER POOL

The compounding pool is a diverse source of stocks that we believe can create long-term value by growing in attractive markets at good rates of return. Growth rates can vary from very high levels (>30% for some software businesses) to GDP+ (~5%) for Stalwarts. However, rather than focusing on absolute levels of growth, we focus on value latency, i.e. where this growth is underappreciated by the market.

The allocation to the compounding pool remained fairly stable, although below peak levels.

Currently, the Fund is exposed to a number of key clusters or groups including 1) Ageing & Health, 2) Interest-rate linked financials, and 3) Transport, niche industrials:

**Chart 9** Compounding pool by sector



Source: CI data | As at 30 June 2023

## Aged Accommodation

The Aged accommodation group includes a range of assets that provide accommodation to people aged 65+, which is growing at twice the rate of underlying population growth.

The Fund is exposed to developer and operators of land-lease communities to the low to middle end of the market. Land-lease communities allow owners to unlock capital as the owner purchases below the cost of their existing homes, buying only the house and leasing the land. The leased land provides a highly stable and growing annuity stream.

## Interest-rate linked financials

This group of stocks are Stalwart-like, primarily providing services in insurance, financial processing and lending, earning both fees and interest income. Our exposures include insurance broking, insurance underwriting, and financial administration related services.

### Transport and niche industrials

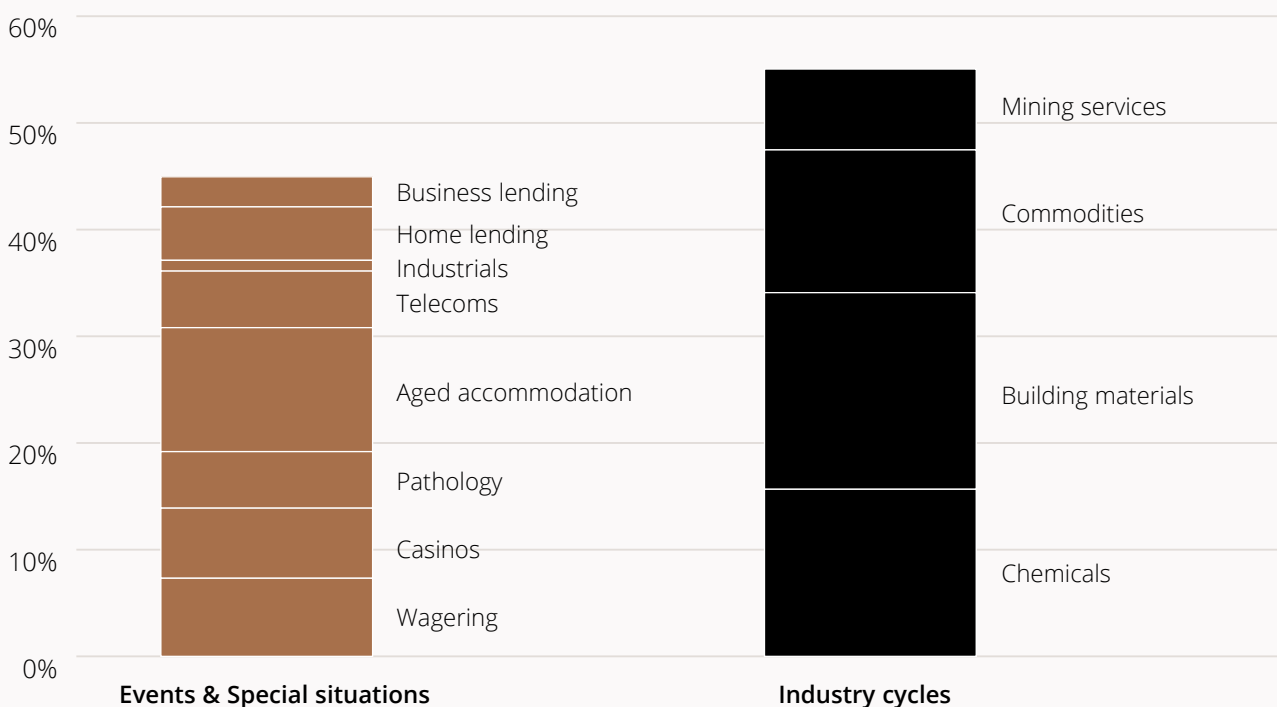
This includes companies that are leaders in areas of ‘business-to-business’ service or niche branded products. This includes providers of less than container load (LCL) freight services, logistics (warehousing) facilities, freight forwarding (Air and Ocean) and rail haulage services for a range of commodities, grains and general freight. It also includes businesses providing distribution services for building materials products.

### REVERSIONARY POOL

The Reversionary pool includes the following key sub-groups:

1. Events and Special Situations
2. Industry Cycles

**Chart 10** Reversionary pool by sector (% of reversionary pool)



Source: CI data  
As at 30 June 2023

### Industry Cycles

We typically look to invest in select industries where returns are below long run averages, return drivers are beginning to exert upward pressure (via capital starvation, bankruptcies or demand is outstripping the supply response, higher incentive pricing is required etc) and valuations remain attractive relative to replacement cost, private market pricing and/or the normalized earnings power of the business.

The Fund owns a number of positions leveraged to increasing expenditure by Resource companies as they not only step up operating expenditure post covid-19 disruptions, replenish their existing mine supply but also pursue greenfield developments into future facing minerals.

The Fund also has a number of exposures to US housing. Our recent trip to the US gave us increased conviction in the positive operating and industry trends for the US housing industry while valuations for these high-quality businesses were attractive following significant de-ratings on the back of the Fed rapidly increasing interest rates.

### Events and Special Sits

In this category we are generally looking for an idiosyncratic reason which has created attractive risk adjusted value latency.

Our favourite sub-category is "Spin-offs" (also called de-mergers) which involve the separation and listing of a division from the parent. There is significant research which supports outperformance of spin-offs over-time relating to a "re-focusing" dividend that combines operating improvements (e.g. cost-outs) with improved capital allocation (spin-offs are sometimes starved of capital) and more aligned incentives for management.

During the year we sold our investment in ESAB, who are a global leader in arc welding equipment such as Cigweld® and cutting automation technology and consumables. ESAB was a spin-off backed by Mitch Rales, founder of Danaher (US\$200bn market capitalization company in the healthcare sector).

We invested in Tabcorp (TAH) which was separated from its lotteries business, the Lottery Corporation (TLC), during the year with the remaining 'stub' comprising Tabcorp's wagering, media and monitoring/venue services businesses. Given the stub is ~20% of the market capitalisation of the lotteries business, it is the 'true' spin-off.

Within this category we also lean into re-capitalizations where a good business has had a bad balance sheet. Often this cleansing act results in lower risk profile ex-post accompanied by significant reversionary value. This was a particularly fruitful category during 2020 for example as good businesses were forced into recapitalizations.

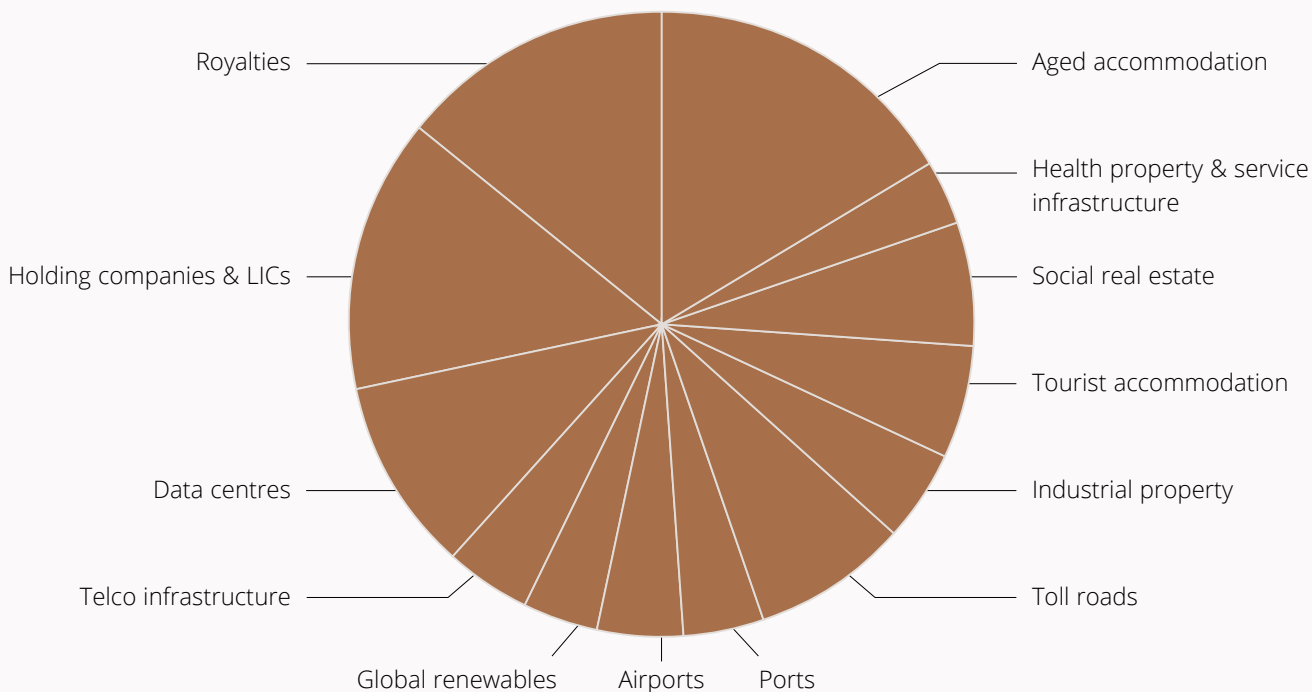
### REAL ASSETS AND INCOME SECURITIES POOL

The Real Assets and Income Securities pool invests in 1) specialty real estate in ageing, health and social sectors, 2) data, renewables and other infrastructure, 3) quality asset discounts, holding companies and royalties.

We seek a combination of strong income streams from rent, deferred management fees, tolls, airport fees and regulated access fees. Income generally grows somewhere between underlying inflation and the level of economic growth. In addition, operators can earn development fees as new assets are added into their portfolios.



**Chart 11** Real asset and income securities pool by sector



Source: CI data | As at 30 June 2023

**Specialty real estate**

This includes business providing rental accommodation to individuals that have limited assets and are dependent on the aged pension as well as developer and operators at the affordable end spanning caravan/tourist parks, rental accommodation in the form of apartments and land-lease communities. The Fund is also exposed to social infrastructure in the form of property leased to large childcare operators and healthcare providers.

**Infrastructure**

The infrastructure exposures include large data centre developers/operators, telecommunications operators, hydropower electricity generation, domestic and offshore airports, toll roads concessionaires in Canada and the US, a bulk and container port, as well as exposure to some of the leading developers of renewable energy assets in the US, Europe and Australia.

**Quality asset discounts, holding companies and royalties**

This includes exposure to diverse ‘asset plays’ backed by long-term conservative management teams where there are valuation discounts based on observable prices as well as a pathway to grow net asset value per share over time. We also like royalty streams over quality, long-life assets/commodities such as gold and oil and gas.

# Risk and portfolio attributes

There are many ways to think about risk. Some considerations include statistical measures summarizing returns profile, drawdowns (maximum fall), and historical volatility at the portfolio level:

**Table 7** Portfolio risk attributes

	*PORTFOLIO	#BENCHMARK
<b>Total Return</b>	1,345.6%	358.5%
<b>Max Drawdown</b>	-40.0%	-47.2%
<b>Best Month</b>	10.9%	10.2%
<b>Worst Month</b>	-18.9%	-20.7%
<b>Positive Months</b>	67.5%	63.6%
<b>Negative Months</b>	32.5%	36.4%
<b>Annualised Volatility</b>	12.1%	14.0%

Cumulative (1 July 2004), pre fees and expenses

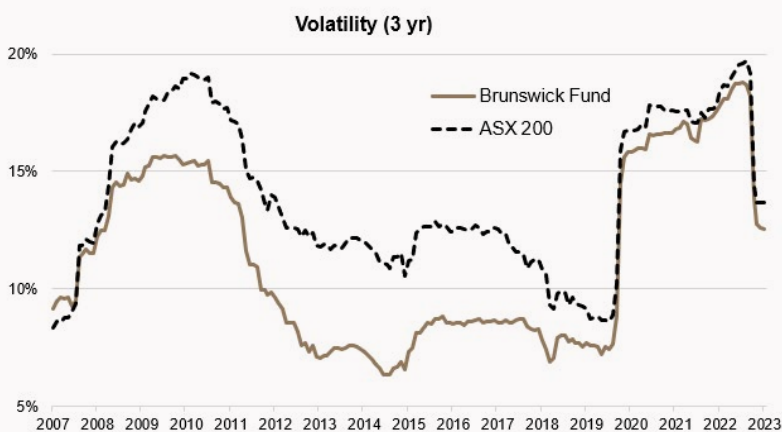
# S&P ASX 200 Accumulation Index

Max Drawdown for the Brunswick Fund occurred December 2007 to February 2009.

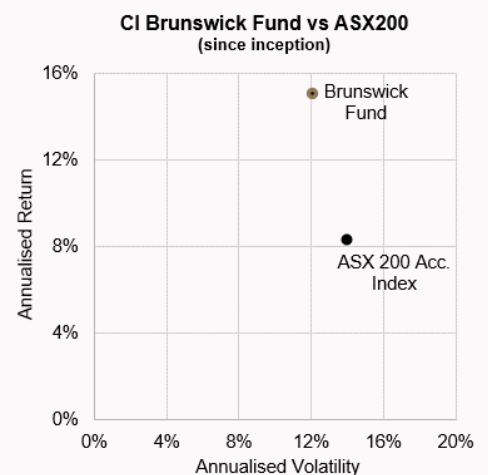
Source: CI data

Past performance is not an indicator of future performance

**Chart 12** Brunswick Fund Historical Volatility

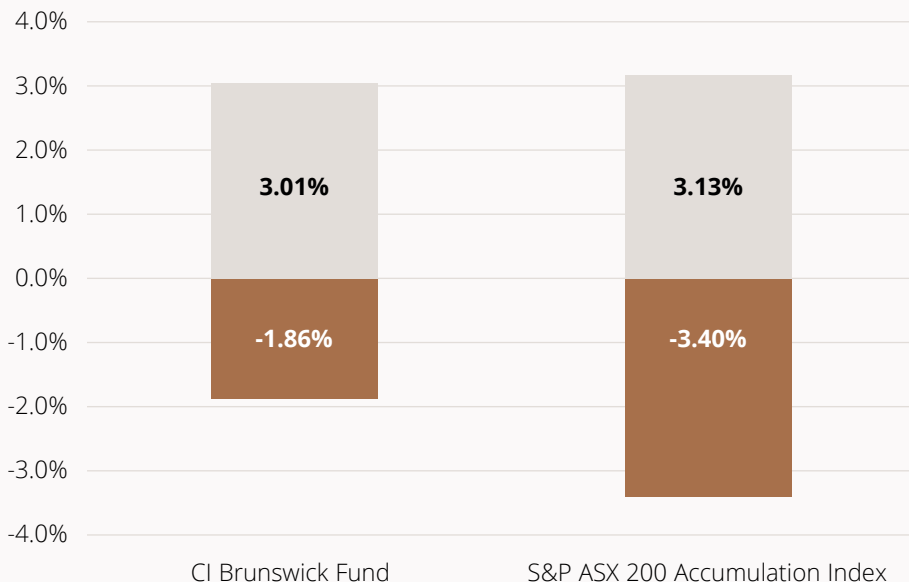


Source: CI data



One important aspect to the Fund's performance historically has been that most of the attribution comes from performing better in down-markets:

**Chart 13 Average Monthly Returns**



Based on 228 monthly data points, 145 up months, 83 down months  
As at June 2023  
Past performance is not an indicator of future performance

However, it is important to note that the Fund will not outperform in 100% of down-markets. Historically it has done this in 80% of down-markets (based on monthly returns).

The Brunswick Fund remains very well positioned across our three capital pools and we continue to find opportunities across each pool. Although some parts of the portfolio performed below our expectations for the year – notably internationals and some small cap stocks – we remain confident in the strategy going forward.

We once again thank you for your ongoing support and please do not hesitate to contact us should you have any questions.

Best Regards,  
**The Brunswick Fund Team**

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