CI BRUNSWICK FUND
QUARTERLY COMMENTARY REPORT

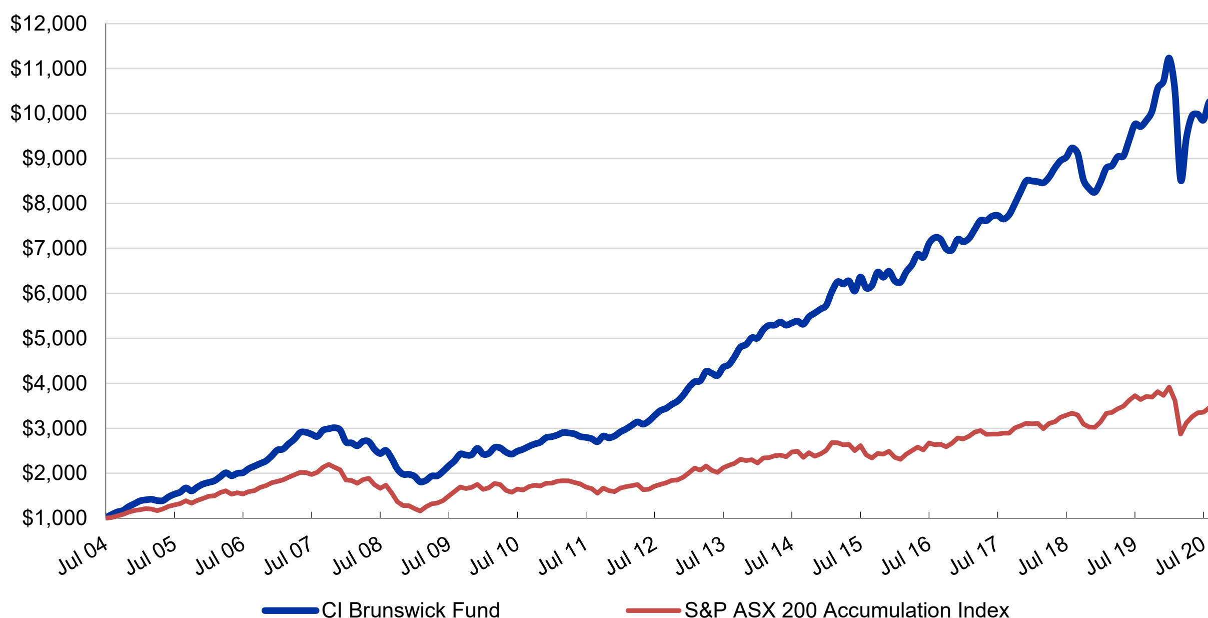
Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

For current performance information please refer to the Monthly Performance Report.

SEPTEMBER 2020

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
LAST 3 MONTHS	2.4%	-0.4%	2.9%
FY 2020	6.1%	-7.7%	13.8%
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*	15.4%	7.7%	7.7%
SINCE INCEPTION^	922.5%	232.7%	689.8

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



Source: Factset

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"There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner, as the result of a voluntary abandonment of further credit expansion, or later, as a final and total catastrophe of the currency system involved."

— Ludwig Von Mises

The Brunswick Fund

Brunswick Fund Mission
1. Leverage CI's VoF stock research 2. Back proprietorial management 3. Allocate across Compounder, Reversionary & Real assets capital pools

The Brunswick Fund is differentiated by its ability to invest in a relatively unconstrained universe of small, medium and large Australian and NZ companies and up to 25% International stocks. Our intention is to purely apply CI's VoF investment philosophy across this universe via a small dedicated team, leveraging CI's domestic and global investors all working with the same investment philosophy and platform. Increasingly we see the advantage this provides for genuine compare and contrast of stocks to improve risk adjusted returns for investors.

The Fund is capacity constrained (**currently hard closed**), to ensure it can take advantage of liquidity events (IPOs, secondary raisings, other dislocations), and invest in quality small and mid-cap stocks.

CI's VoF process leans into qualitative research, deep relationships, and people. Our aim is to back management teams that display proprietorial behaviours – teams that think and act like owners of businesses. We categorise these managers into three groups including Family linked and Founder led (40% of the Fund at present), Owner-Operator Cultures (30% of the Fund), and Specialist Focussed Managers (27% of the Fund).

The Fund is focused on 3 broad pools of opportunity – compounder, reversionary and real asset and income securities.

Market and Portfolio Performance

After two volatile quarters (March and June), stock markets returned to some level of normality. In stark contrast, the ongoing spread of the virus has meant that many countries across the world continue to be impacted by various forms of lock-downs. However, supported by government stimulus, economic activity continued to recover from the lows of March/April.

In Australia, the economic recovery slowed after Victoria went into stage 4 lockdown. The October 2020 budget offered further stimulus measures, in particular to help support business, with government debt now expected to well exceed $1Trillion sometime during the next few years.

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Although we spend more time understanding companies from a 'bottom-up' perspective, the 'top-down' issues can be equally important, particularly when assessing operating, industry and strategic trends – the 'o' in our 'VoF'. There are also various times when these issues can dominate how stocks are priced in the market, presenting both risk and opportunity.

We have flagged some of the more relevant top-down issues in recent quarterlies emanating from the pandemic. On a shorter-term timeframe:

- At some stage, we expect a normalisation of restrictions and social distancing. There are a number of quality companies that have been impacted by the pandemic, but will benefit when conditions normalise ~ eg Qantas and Auckland Airport (see further discussion below).
- Short-term beneficiaries of the pandemic, where operating trends are likely to remain strong ~ eg ARB (see detailed discussion below)

In addition, a number of the company 'clusters' that featured in the Fund prior to Covid-19, appear to now have even stronger top-down support:

- **New economy**, for example stocks benefitting from a likely acceleration of the trend to digitisation and the cloud ~ Xero (XRO), Intuit (INTU), Elmo (ELO), and Infratil (IFT)
- **Community & ageing**, for example aged accommodation providers ~ Lifestyle Communities (LIC), Ryman (RYM), and Eureka (EGH)
- **Government**, for example spend on health and preparedness ~ CSL, and beneficiaries of medium term rising government debt levels and central bank activity ~ Northern Star (NST) (detailed discussion below)

* * * *

During the September 2020 quarter, the ASX200 Accumulation Index returned -0.44% and for the 12 month period to September 2020 returned -10.21%.

The portfolio faired relatively better, returning +2.41% for the September quarter and +3.87% for the 12 month period, outperforming the index by 2.85% and 14.08% respectively.

Key contributors to portfolio performance during the 3 month period include **Reece (REH)** (strong FY20 result, particularly in the US), **Brickworks (BKW)** (announced new industrial JV lease to Amazon) and **Arena REIT (ARF)** (solid rent collection during Q4, improving industry trends)

Portfolio stocks that performed relatively poorly include **Ampol (ALD**) (disappointing announcements on capital management), **Aurizon (AZJ)** (concern that coal volumes will fall given coal price pressure) and **Elmo (ELO)** (market digesting its capital raise and M&A uncertainty).

Reece (REH), Australia's largest distributor of plumbing products, reported a better than expected FY20 result, despite the many challenges that Covid-19 presented. Against a backdrop of declining residential approvals/completions, the essential nature of maintenance plumbing came to the fore with a stable result in Australia and NZ (Rev +1%). US organic growth was strong (+7%) despite the US

being more significantly impacted by the pandemic. New housing demand in the US continues to improve, underpinned by ultra-low mortgage rates and an underbuild of new houses since 2006.

The value latency we see in Reece is all about the opportunity for long-term compounding. Two years ago Reece acquired US-based Morsco. Although offshore M&A can be risky, Reece has the opportunity to help consolidate the more fragmented US market with potential for years of capital deployment and growth. Over time this should lead to further scaling and improved profitability. The compounding achieved by other US distributors like Watsco, Poolcorp, Fastenal, and W.W. Grainger, are useful references.

The odds of successful execution are further improved by backing a ‘proprietorial’ management team and Reece sits in the ‘Family-linked’ and ‘Founder-led’ category. As majority shareholders, the Wilson family has been at the helm of Reece for the last 50 years. The best ‘family-linked’ companies bring with them an enduring mindset. In Reece’s case many seemingly small decisions – owning rather than leasing property, over-investing in inventory to avoid stock-outs and higher levels of IT spend versus peers, collectively explain why Reece takes most of the industry’s profits in Australia.

Northern Star (NST), which was added to the Fund last year, announced in early October a proposed merger (nil premium) with fellow WA-based gold miner **Saracen (SAR)**. Earlier this year, the two groups separately acquired a 50% stake in the KCGM or Superpit gold mine in Kalgoorlie from global miners Barrick and Newmont. The combined business, with a ~$18bn market capitalisation, will be a top 10 gold producer globally and will focus on three main, world-class mining areas which are expected to grow production by ~30% over the next few years.

In the combined entity we see numerous opportunities to deploy capital in internal/low risk projects to create value, with both teams having strong track records of doing this over the last 10 years. For example, recent acquisitions POGO and KCGM have opportunities for optimisation and mine expansion over the medium term. Assets in Kalgoorlie and the Yandel belt have various mill expansion, optimisation and adjacent drilling/growth options (even pre-merger).

Management also identified $1.5-2bn NPV pre-tax merger synergies which relate to cost savings – overlap of corporate costs, simplification of the JV structure, procurement and tax/depreciation – and operational savings such as the ability to optimise milling costs per tonne (multiple mines, multiple mills in close proximity), and improve recovery rates /optimise Northern Star’s stockpiles.

Both Northern Star and Saracen have highly focused proprietorial management teams with deep operational experience. Northern Star is a founder-led company with Executive Chairman Bill Beament instrumental in building the company from a small junior miner, to a top 10 global gold miner today. The two company cultures are very similar and should integrate relatively well. The acquisition combines sector leading open pit and underground mining skills.

Eureka Group (EGH), a provider of affordable rental units for independent seniors, reported a very resilient FY20 result and start to FY21 during the quarter. It is one example of a company in Australia to experience strong operating momentum throughout the pandemic.

EGH sits in our real asset and income securities pool, reflecting its quasi-government backing, demographic tailwinds, free cash flow generative business model and an asset base supported by property and land.

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At CI we believe that behind every number there is a person and a behavioural overlay. This is underscored by the Corporate Governance reset undertaken by the company 18 months ago now beginning to bear fruit. Despite Covid-19, the company increased occupancy 400bps, grew EPS 19%, achieved 6% growth in net tangible assets and maintained stable gearing levels.

We continue to see a significant opportunity for Eureka Group to become the scaled player in this highly fragmented market. Importantly, incremental returns from acquiring additional villages are high (>20%) reflecting attractive acquisition pricing (15%+ levered IRR's) combined with EGH's sub-scale nature (corporate overheads >60% of PBT).

Given this opportunity, we think the addition of Greg Paramor AO to the EGH Board is a key positive. Mr Paramor achieved a formidable track record of growing property businesses to significant scale over the past few decades (Growth Equities Mutual, Paladin, James Fielding Group, Folkestone). This invaluable experience should hold EGH in good stead as it looks to scale its operations further.

During the quarter, **Ampol (ALD)** announced the establishment of an unlisted property trust that will hold 203 freehold Convenience Retail sites. A Charter Hall and GIC consortium will acquire a 49% minority interest in the trust for $682m with Ampol retaining a 51% controlling interest. The trust will receive approximately $77m in rental payments from ALD in the first year (100% basis) and the transaction, which reflects a cap rate of 5.5% and values the entire property trust at $1.4bn is expected to close by the end of 2020. Whilst it is pleasing to see ALD begin to unlock the latent value across the asset base, the transaction is of smaller scale than previously outlined to the market (203 sites as opposed to 250 sites). With ~230 freehold property sites remaining 100% owned by ALD post transaction, we would encourage further monetisation across the portfolio.

Although we recognise that the heightened levels of uncertainty in the very short term require some degree of prudence, we believe flexibility around capital management frameworks need to be exercised in a manner that both delivers value to shareholders and takes advantage of market opportunities when they arise. In this case, with net debt / EBITDA towards the lower end of management's 1.5-2.0x target post completion of the property transaction, we were disappointed with the lack of intent shown in recent announcements to return capital to shareholders. With two large Hybrid issuances in the market in recent weeks (Scentre Group (A$4.1bn) and AusNet (A$650m)), we would encourage ALD to execute on the A$300-500m hybrid issuance proposed in late 2019 and begin the process of distributing the significant franking credit balance (~$3ps) to shareholders.

* * * *

ARB Corporation (ARB) was added to the Fund during the March/April downturn. The company designs, manufactures and sells four wheel drive (4x4) accessories globally, and has built enduring brand value over the past 45 years with its products resonating not just with 4x4 fanatics.

ARB is a compounding stock (growth subset of value) as we believe the company is well positioned to further monetize its IP and brand globally. Over the last 25 years, ARB has grown sales at a compound rate of 11% p.a. and EBITDA at 15% p.a. ARB sits in our Family-linked and Founder-led management category, having been led by Anthony, Andrew and Roger Brown since inception.

Initially, when the pandemic hit, ARB was negatively impacted by forced shutdowns in many of its key geographic regions. Subdued and uncertain consumer demand led to a significant fall in ARB's order

book and the need to scale back manufacturing, reduce operating and capital expenditure, preserve cash and secure liquidity sources.

This offered an attractive opportunity for us to once again 'pounce' on the stock.

As the global response to the pandemic stabilised, ARB's order book recovered strongly in June and July, both record months for the company. In some ways, the pandemic has now become a tailwind for ARB, with many consumers unable to spend on international travel and other discretionary items, spending has diverted for example into products related to travel/holidays. Therefore, even despite challenges still in Australia with Victoria in stage 4 lockdown, ARB recently reported a strong Q1 2021 sales growth of 17.7% (versus Q1 2020), underpinned by export market growth.

In addition to an ongoing recovery and growth in domestic operating trends as Victoria reopens, we still see latent value in ARB continuing to grow across its export markets and original equipment manufacturers over the medium term. ARB has a conservative financial structure (net cash balance sheet), yet with a willingness to take calculated risks over the years.

During the month of April we also participated in two recapitalisations, **Auckland International Airport (AIA)** (in April) and **Qantas (QAN)** (in June).

Our framework for investing in these companies was similar. Both are quality businesses with strong management, significantly impacted by an exogenous event (Covid) in which the capital raising would provide them with the balance sheet duration to participate in the recovery.

QAN falls into our cyclical subset of value. While we expect periodic turbulence, QAN's iconic brand, seasoned management team and its improved balance sheet leaves the company well positioned to meet these challenges.

While we are attracted to QAN's significant leverage to a broad based recovery in travel, it is the downside protection should this not eventuate which in our view creates positive asymmetry. This reflects its improved balance sheet, its highly cash generative Frequent Flyers division and importantly its domestic travel orientation which is much higher margin than international (Domestic and Frequent Flyer divisions generated 80% of QAN's FY19 EBIT) and has a higher probability of recovering more quickly.

While we have no particular insights regarding vaccines (or the timing), improved treatments, border openings etc we would observe that industry returns have been under significant pressure, capacity has been reduced, a key competitor (Tiger) has departed (notwithstanding Rex incrementally expanding), long standing unfavourable cost structures are being renegotiated, future industry investment will likely moderate and it is reasonable to expect a more rational, returns motivated competitor in Virgin. These industry pressures and reactions favour higher industry returns over time in which we see QAN as well placed to capture more than its share.

AIA is a highly attractive long term infrastructure asset operating as a monopoly with a perpetual asset life (unlike Sydney airport for instance). Tourism is one of New Zealand's key industries (of similar size to the Dairy industry), and AIA is the key gateway having grown its share of international arrivals significantly over the past decade to around 75-80% (pre-Covid).

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For the 20 years prior to the pandemic, AIA delivered growth in passengers at more than 2x GDP. AIA also saw a 3-4% p.a. improvement in revenue per passenger, underpinned by growth in international passengers (who are more valuable to AIA as they tend to spend more in Retail). In the short-term though this profile has clearly been significantly impacted by Covid. In particular with next to zero international travel at present.

Although Covid-19 is by far and away the worst event AIA has had to deal with, the last 20 years of operations and growth has included the events of September 11 and the global financial crisis. The recovery following these two prior events was strong.

Despite its greater reliance on International travel returning (vs QAN for example), this risk factor is partly mitigated by AIA's lower operating leverage, low current cash burn and its premium tangible asset base.

Relative to Sydney Airport, AIA maintains a more conservative gearing structure and dividend payout policy. Over the medium-term AIA still has capacity to deploy capex at high incremental returns (property, car parking and retail) with adjacent vacant land currently being developed for industrial purposes, in many cases unrelated to airport activities

The Portfolio – Strategy, Process and Structure

Objective & Structure

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

- Long-only, focused portfolio (20-40 stocks) with VoF qualities.
- No leverage, no derivatives, no shorting.
- Non-index, endowment-like philosophy across domestic and international markets.
- 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 portfolio).
    - 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 portfolio 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 companies 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** (29% of the portfolio)
    - Sturdy, reliable and generally larger companies with world-class privileged markets and competitive positions. (Mainfreight, TPG Group)

  - **Growth companies** (24%)
    - 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** (11%)
    - Stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. (BHP, Ferguson)

  - **Quality turnarounds** (7%)
    - Sound businesses with good management and balance sheets. We especially like spin-offs and government-to-private turnarounds. (United Malt, 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.
    - Gold companies
    - Agriculture

  - **Bond-like equities** (11%)
    - 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. (Arena REIT, Ferrovial)

- **Asset plays** (17%)
  - Owner, operator managers with long term commitment to shareholders growth in asset value. Stocks with strong or improving balance sheets trading at discounts to net asset value or replacement value. (Brickworks, Northern Star)

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.

Currently, the portfolio holds around 3% cash and has around 16% of assets invested in overseas stocks that own businesses in USA, Canada, UK and Mexico.

Portfolio attributes as at September 2020 are summarised below:

P/E	26.4
Beta	0.90
Yield	2.5
P/Book	1.80
ROE	6.9
Tracking error vs. ASX 200	5.54
Stock Number	38

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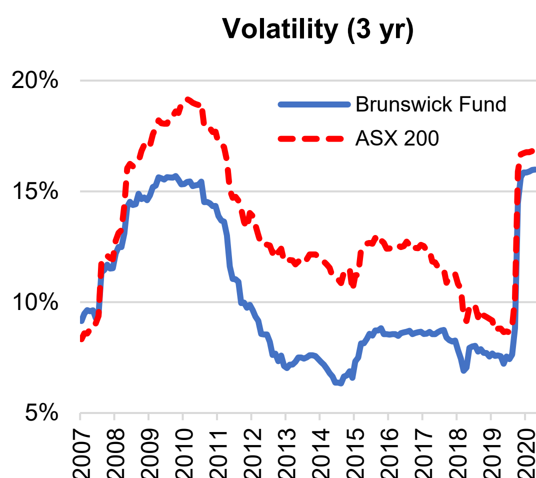
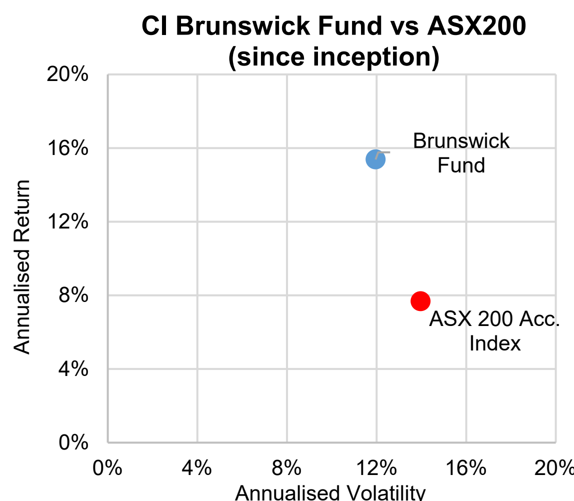
Portfolio Risk Metrics

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	+923%	+233%
Max Drawdown	-40.0%	-47.2%
Best Month	+10.9%	+8.8%
Worst Month	-18.9%	-20.7%
Positive Months	68.7%	63.6%
Negative Months	31.3%	36.4%
Annualised Volatility	+12.0%	+14.0%

*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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