CI Brunswick Fund

COOPER INVESTORS

QUARTERLY COMMENTARY | DECEMBER 2023

AFS LICENCE NUMBER 221794 ABN 26 100 409 890

FINANCIAL YEAR	**Portfolio	#Benchmark
2024 FYTD	4.6%	7.6%
3 Year*	9.5%	9.3%
5 Year*	12.9%	10.3%
10 Year*	11.7%	7.9%
Since inception*	**14.9%**	**8.5%**
Since Inception^	**1412.2%**	**393.2%**

* Annualised
^ Cumulative (1 July 2004)
\# S&P/ASX 200 Accumulation Index
** Returns are gross of fees and expenses
Past performance is not necessarily a reliable indicator of future performance
Data Source: Internal CI data reports, 31 December 2023

"I think all good investing is value investing, and it's just that some people look for values in strong companies and some look for values in weak companies, but every value investor tries to get more value than he pays for."
Charlie Munger, Vice Chairman – Berkshire Hathaway

QUARTERLY PORTFOLIO HIGHLIGHTS

For the December 2023 quarter the CI Brunswick Fund returned +5.38% (gross, or before fees), which compares to the ASX200 Accumulation Index return of +8.39% over the same period.[1]

The Fund's Reversionary capital pool was the strongest contributor (+2.66%), followed by Compounders (+1.87%) and Real Asset and Income Securities (+0.44%), while cash contributed +0.37%.

The Fund lagged the sharp rally of the ASX 200 from late October through the end of the year (+12% from its lows).

One reason was the Fund's 'underweight' position in iron ore stocks relative to the index (while we hold BHP, it's at a lower weight relative to the ASX 200 weight, and we don't hold RIO or Fortescue). These iron ore stocks performed particularly well as the iron ore price rallied from US$120/T to US$140/T. Of note, the iron ore price is now in the top decile of its 10-year price history. As we've previously highlighted, the underweight position can lead to short-term under/out performance.

The Fund retains a higher indirect exposure to commodities via 'picks and shovels' companies in the mining services and explosives sectors. We continue to see strong medium-term outlook for these stocks, with less volatility to specific commodity prices. However, these stocks did not perform as strongly as the direct commodity exposures over the past couple of months. The Fund's underweight in iron ore, plus our non-holding of some other large capitalisation stocks (for example the Banks), explained about half of the underperformance.

At the stock level, key contributors for both the quarter and the FYTD were **Regis Healthcare**, **Newscorp** and **Brickworks**. Key detractors were **Star Entertainment** (the Fund retains only a small position), **Ryman Healthcare** (also a reduced position) and **Incitec Pivot**.

The recent rally was sparked by a more dovish outlook for interest rates following softer economic data in the US and Europe. Some of the Fund's stocks that are most leveraged to higher interest rates – Computershare and QBE – also performed poorly. Despite this, we still see a positive outlook for both stocks in coming years and attractive levels of value latency.

Star Entertainment (SGR) continued to under-perform following its recent capital raising. There are several near-term issues overhanging the company including whether the business will reclaim its casino licenses in NSW and QLD, the quantum of the upcoming AUSTRAC fine, and the delayed opening of their new integrated resort in Brisbane. We have significantly reduced our position in SGR and need to observe improved operating and proprietorial management trends and/or de-risking milestones before increasing our weighting.

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Regis Healthcare (REG) was a strong contributor during the quarter with solid operating trends, an accretive acquisition announced, and growing confidence that the inadequate funding of the sector will be partially addressed in the near-term. We outlined the VoF proposition for Regis in the previous quarterly, and despite the strong recent outperformance, we continue to see significant latent value in the business with ongoing positive operating and industry trends given the duration and severity of the prior ~seven year downturn ("hubris to humility" cycle).

At the start of the quarter we invested in Louisiana Pacific (LPX-US), a large producer of Oriented Strand Board (OSB: similar to plywood) and Engineered Siding, both used in Housing. LPX is a key competitor to Australian-listed James Hardie (JHX). The investment in LPX followed our September trip to the US, which included several LPX sites, where we were struck by the team's immense pride in the quality of their product offering, the company's numerous value latencies and importantly a high degree of focus and intentionality.

LPX's current CEO William Southern (an ex-Forester), was appointed in 2017. The company has since undergone a significant strategic shift away from commodity wood products towards higher value-add products, particularly their Sidings business which generates higher and more resilient returns. This positive strategic shift also extends to their capital allocation with the company having repurchased ~50% of their share base in the past four years. We expect this shareholder focused capital allocation will continue.

We see significant value latency within LPX over the coming decade as they 1) convert more OSB mills to Siding mills (each dollar invested creates >$1.50 of value on our estimates); 2) increase the proportion of Sidings volumes to "Expert Finish" which generates ~2x the gross margin; and 3) convert a very large OSB mill (Wawa) which they recently purchased out of bankruptcy into a new Siding mill. These latencies are in addition to market share gains as Engineered Wood and Fibre Cement continue to take share from Vinyl and a large opportunity to increase LPX's exposure to the Repair and Remodelling ('R&R') market via improving their distribution capabilities.

The investment in LPX followed our divestment of their competitor, James Hardie, post comparing and contrasting the relative value latencies and proprietorial cultures. This 'compare and contrast' approach is where we have created the most value from investing in international companies in the past.

OBSERVATIONS FROM THE ROAD

In November we visited the US, with a focus on Newscorp (NWS). Our NWS VoF proposition is based on 1) the latent value we detailed in our sum of the parts analysis in the September quarterly report, 2) positive trends underlying Dow Jones, NWS most important business, and 3) an increased focus on realising value from NWS' proprietorial management team. We met with both NWS CEO and Dow Jones CEO, as well as other related companies.

It is clear Dow Jones has a strong growth profile with improving quality attributes such as more recurring, subscription-based revenue, which is under-appreciated by the market. NWS has given investors only limited exposure to Dow Jones CEO Almar Latour so far, although it seems this will change going forward. Almar articulated a clear strategy with three key areas of focus:

1. Vertical market opportunities – Dow Jones is building expertise in verticals like energy through its recent acquisition of OPIS, providing industry benchmark data in the energy sector. Post acquisition, NWS has been able to increase OPIS' organic growth rate from 7% p.a. to 15% p.a., following increased investment in sales and product. Other vertical opportunities discussed include 'leadership' content for C-suite executives, commodities data more broadly, as well as FX data.
2. Horizontal opportunities – principally their customer and sales strategies, with the aim of increasing their share of wallet.
3. Transformation – largely operational efficiencies as Dow Jones focuses on key growth segments.

We also gained increased confidence that Dow Jones is positioned to benefit from Artificial Intelligence, given its significant content databases that can be monetised, and the opportunity that exists in multi-language products. Finally, it seems likely Dow Jones margins will continue to improve. In its most recent quarterly earnings report NWS stated that revenue from B2B customers is now greater than B2C customers. Our sense is this is a positive trend given B2B retention rates tend to be higher than B2C, supporting higher margins in this segment.

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During the quarter, US activist fund Starboard Value Partners announced an investment in NWS, arguing the market is deeply under-valuing NWS portfolio of businesses. Starboard is lobbying for a spin-off of REA and Move, which would 'shine a light' on the remaining portfolio (the 'rump'), with Dow Jones the most important part of the rump. We agree and believe this would likely see a significant re-rating of NWS. Although NWS owns a controlling 61% stake in REA, its ownership is essentially a financial investment in a listed company. This asset has grown to such an extent that it has obscured everything else in NWS.

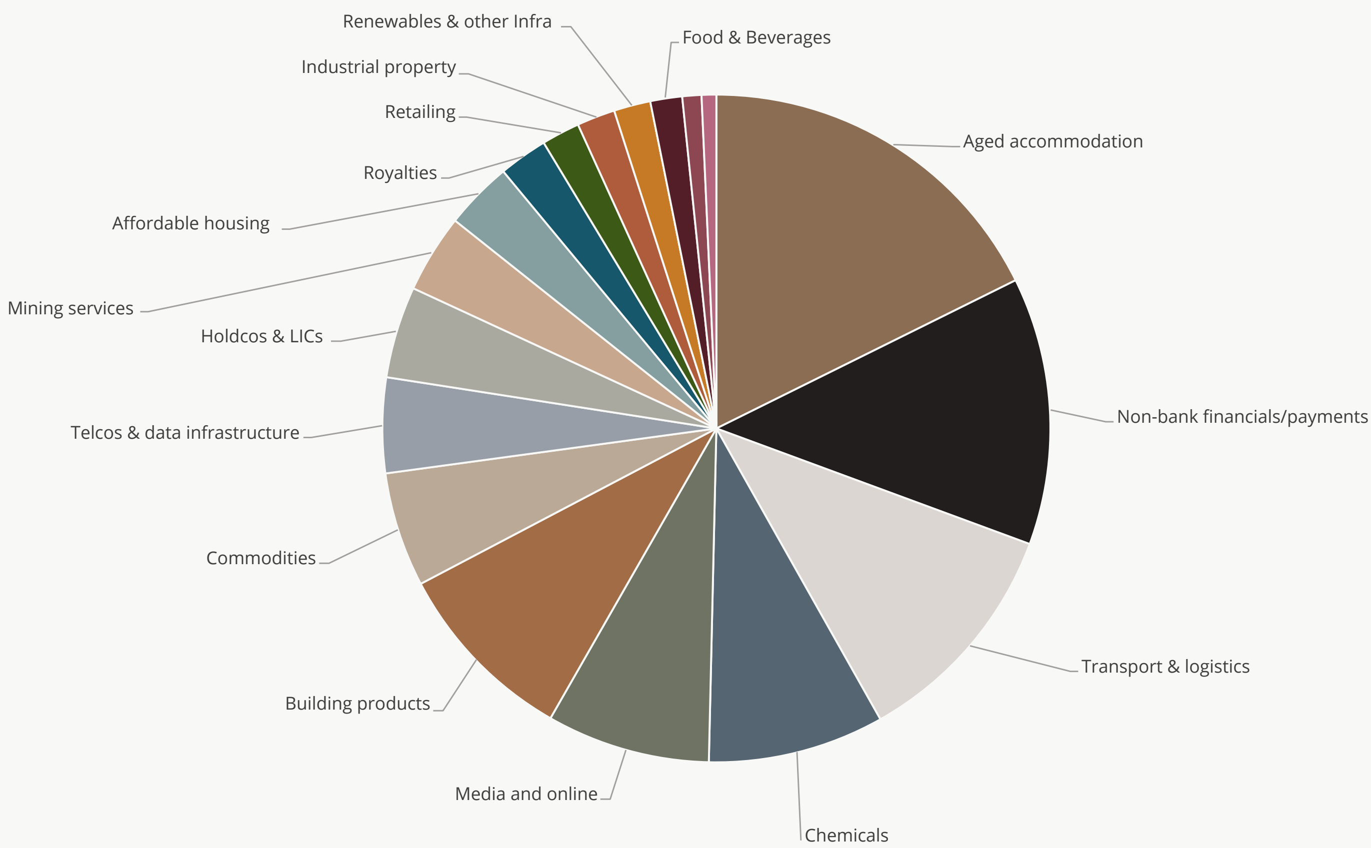
Outside of NWS, we also visited companies across the homebuilding, steel, gaming, industrial property and data centre industries. Many parts of the US economy are seeing trickle down benefits from government stimulus spending related to the Inflation Reduction Act, and the CHIPS and Science Act. While there is some evidence economic activity has slowed more recently as higher interest rates impact various sectors, the US economy still appears robust in an overall sense.

PORTFOLIO POSITIONING

There was little change in the Funds' allocation to the three capital pools. We have been adding to the real asset and income pool over 2023, with an approximate equal weighting across each pool at present.

In terms of industry, the Fund balances diversity with a focus on clusters like 'aged accommodation', and an overall relatively defensive positioning. The Fund remains very different to the benchmark ASX200.

Brunswick Fund by Industry



Source: NAB Asset Servicing, CI data, 31 December 2023

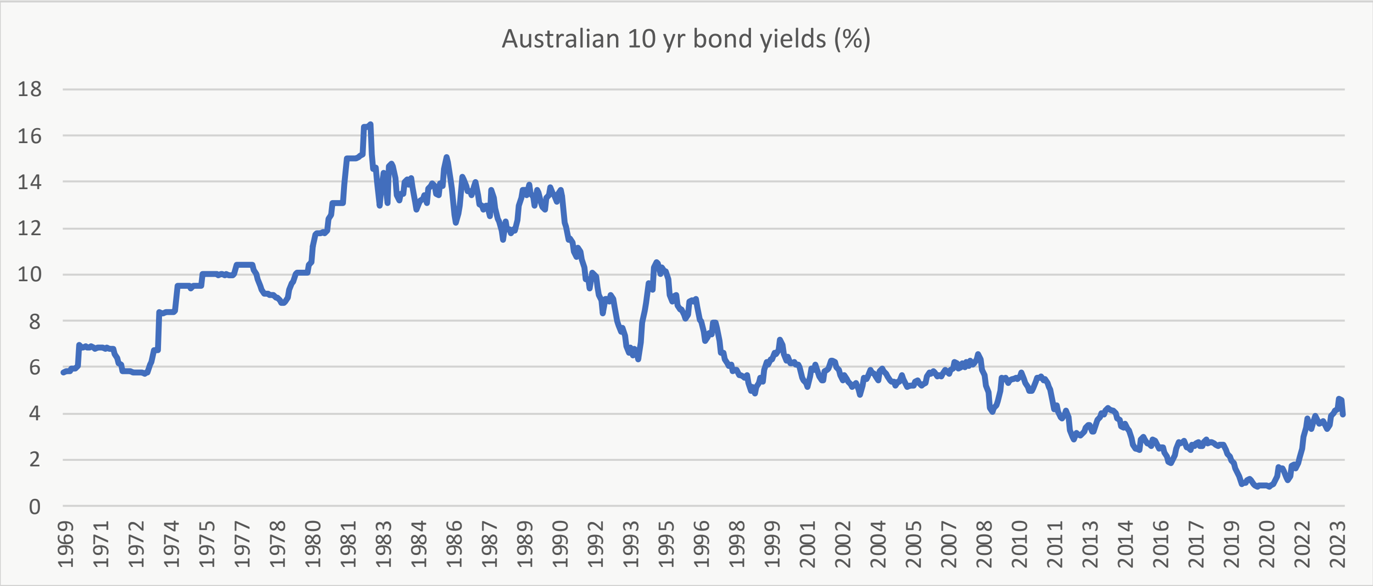
Several clusters remain of interest in terms of current and future opportunities:

- Ageing demographics and community
- Affordable housing and other residential exposures where demand and rental growth is strong
- Infrastructure and property leveraged to data, renewables and industrial /online
- Companies benefiting from the US housing cycle
- Attractively valued 'platform' companies that generate high incremental returns on capital as they grow
- Companies benefiting from increased spend on domestic infrastructure, for mining, road, rail and other major projects
- 'Picks and shovels' companies servicing the mining sector set to benefit from demand for future-facing commodities
- Assets in the ground that are valued well below replacement cost, earning low to mid-cycle returns on capital at present, that will benefit from an improved supply/demand dynamic
- Non-bank financial companies benefiting from a normalisation of interest rates
- Small and mid-cap companies more leveraged to the next profit cycle

MARKET OBSERVATIONS

In the September quarter, we observed how long-term interest rates had increased to the level of short-term rates (i.e. the yield curve had flattened), resulting in equity markets falling around the world. In the December quarter, this reversed, with markets now expecting interest rates to be cut in 2024 and a lower level of long-term interest rates. Following this downward reset in rates, equity markets recovered strongly.

As the chart below highlights, long-term (10 year) interest rates have increased to a level that is consistent with the 20-year average for these rates, noting this average includes a period of structurally lower rates post the 2009 GFC.



Source: Reserve Bank of Australia

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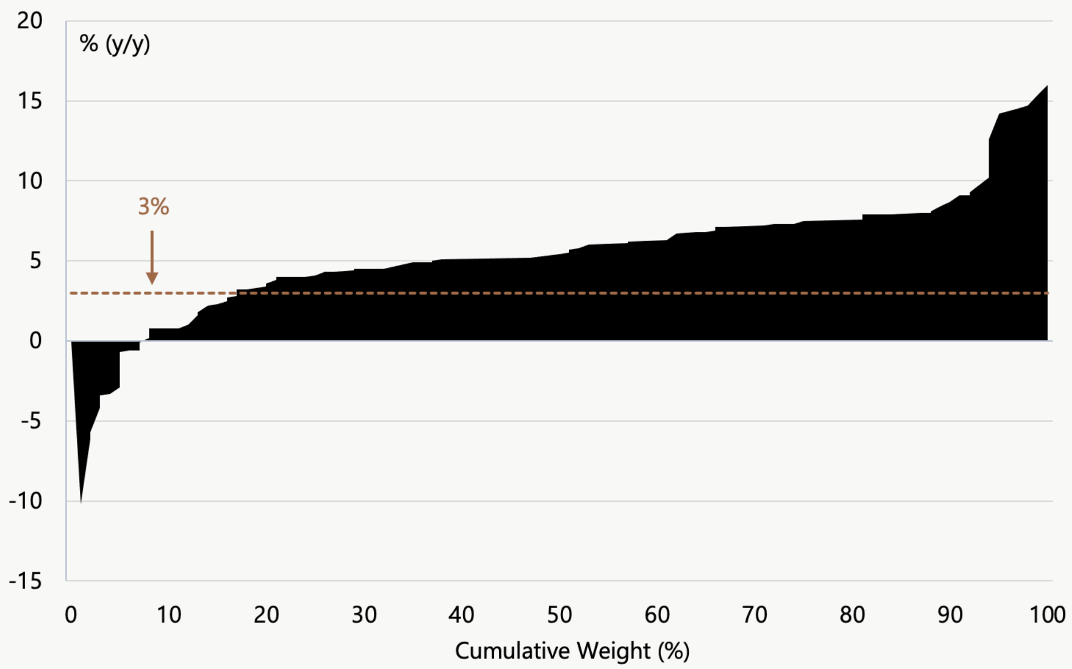
We obviously don't know how this will play out, and we would observe there are still challenges to Australia cutting interest rates in 2024. As the chart below highlights, current above-average inflation in Australia is broad-based (i.e. it is above average across many sub-categories of products and services). This could prove trickier to normalise relative to inflation concentrated in only a few sub-categories.

Inflation by CPI expeniture class item – Year-ended, Sep qtr 2023 (%)



Source: Australian Financial Review, Reserve Bank of Australia

At the portfolio level, some of the Fund's stocks will perform better in a higher interest rate world, while others will perform better if rates are cut. Quite a few should do well in either environment.