CI Brunswick Fund

COOPER INVESTORS

AFS LICENCE NUMBER 221794
ABN 26 100 409 890

QUARTERLY COMMENTARY | MARCH 2023

FINANCIAL YEAR	**Portfolio	#Benchmark
2023 FYTD	11.5%	13.6%
3 Year*	18.4%	16.5%
5 Year*	10.9%	8.7%
10 Year*	13.3%	8.2%
Since inception*	**15.2%**	**8.4%**
Since Inception^	**1315.9%**	**353.9%**

* 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

"I have made a sufficient number of mistakes in my life that there is little danger that I will become overconfident. In my opinion, a good investor needs to strike the right balance between confidence and humility"

"We will catch more and bigger fish if we fish in waters less fished in by others" **Edgar Wachenheim III, from 'Common Stocks and Common Sense'**

"People don't consciously choose to invest with emotion – they simply can't help it" **Seth Klarman**

QUARTERLY PORTFOLIO REVIEW

For the FY23 FYTD (9 months to end of March), the Brunswick Fund returned 11.5%, which compares to the ASX200 Accumulation Index return of 13.6% over the same period.

It was a disappointing Q3 (0.9% vs Index 3.5%). Looking across the FYTD, performance has largely been impacted by stock specific factors. For example, two of our asset rich companies (Star and Ryman) undertook capital raisings to shore up their balance sheets, Napier Port and the surrounding catchment area was hit by Cyclone Gabrielle and Computershare under-performed as interest rate expectations declined materially.

Two dilutive capital raisings in one quarter is frustrating as we pride ourselves on prioritizing companies with balance sheet latency. In the pursuit of value we underestimated the tradeoff between value and risk pressures resulting from stock specific management decisions and industry headwinds. The capital raisings whilst dilutive to existing shareholders were warranted. But it is a good reminder why we are believers in strong balance sheets.

Across the rest of the portfolio we are confident in the balance sheet optionality for the vast majority of stocks with well below targeted gearing levels and many with a net cash balance sheet. We expect some of our Capital Allocation Champions (CAC) in particular to add significant value through this current cycle as economic pressures build across many industries.

The other main area of performance drag related to stocks linked to property markets (Lifestyle Communities (LIC) was a drag in the quarter, Eureka Group (EGH) in the FYTD), where the sharp changes in the cost of capital has driven lower earnings multiples and increased market concerns for both volume and price trends. The medium-term outlook for these stocks remains strong as they all possess proprietorial overlays and target both affordable housing and the aged demographic; two sources of significant structural growth.

While we are chastened by recent performance, this has strengthened our resolve to lean further into CI's proven VoF process and in certain situations more actively pursue corporate engagement to expedite the latent value we see.

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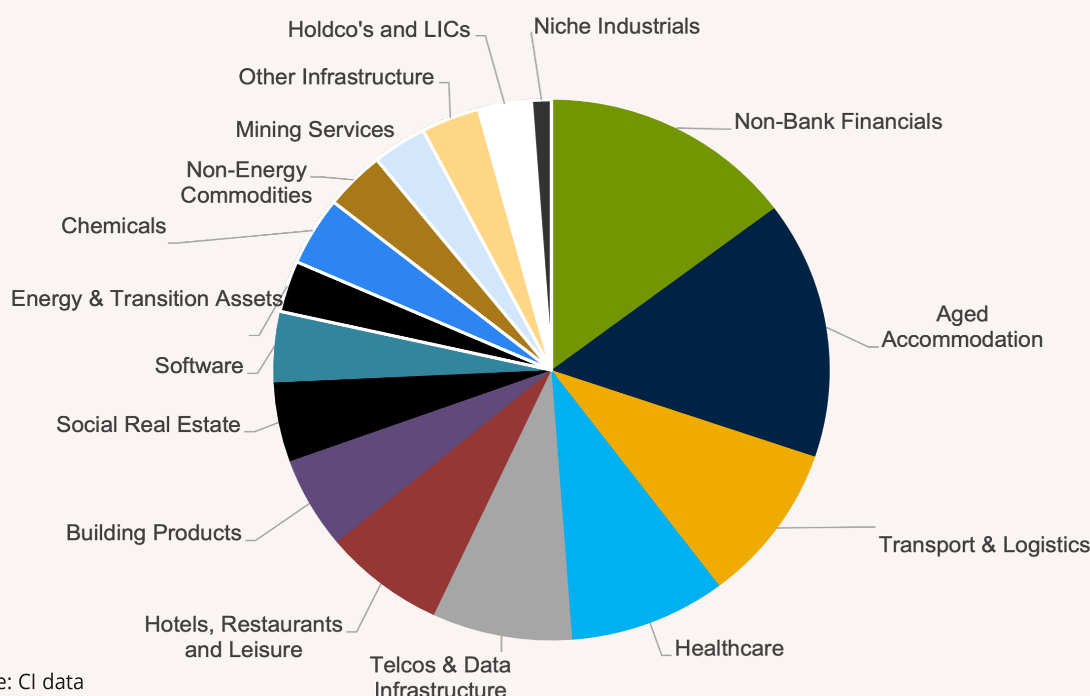

Source: CI data

The Fund's strategy is to search for the best risk-adjusted value opportunities across our three capital pools. The output of that strategy is that the Fund remains quite different to the index as shown below largely driven by no major Bank exposure and a small mining and commodities exposure.

We are currently positioned relatively evenly across Compounders and Reversionary with slightly lower exposure to the Real Assets and Income portfolio.

Compounders Growth + Stalwarts	Reversionary Cyclicals + Low-risk turnarounds	Real Assets & Income Bond-like equities + Asset plays
Underappreciated growth	**Low risk sources of reversionary value**	**Uncorrelated, endowment-like assets**
• Runway for organic growth • Proprietorial managers (family's and founders and owner-operator cultures) • Pathway of value creation • Identifiable value based on traditional metrics	• Quality businesses • Defensive sectors • Capital or supply scarcity • Balance sheet repair • Corporate events (spin-offs, restructurings etc) • Specific pathway for value creation (eg cost out) • Specialist (expert), aligned management teams	• Asset backing • Lower correlation to markets • Inflation protection (income or assets) • Ability to grow asset value over time • Evidence of valuation anomalies

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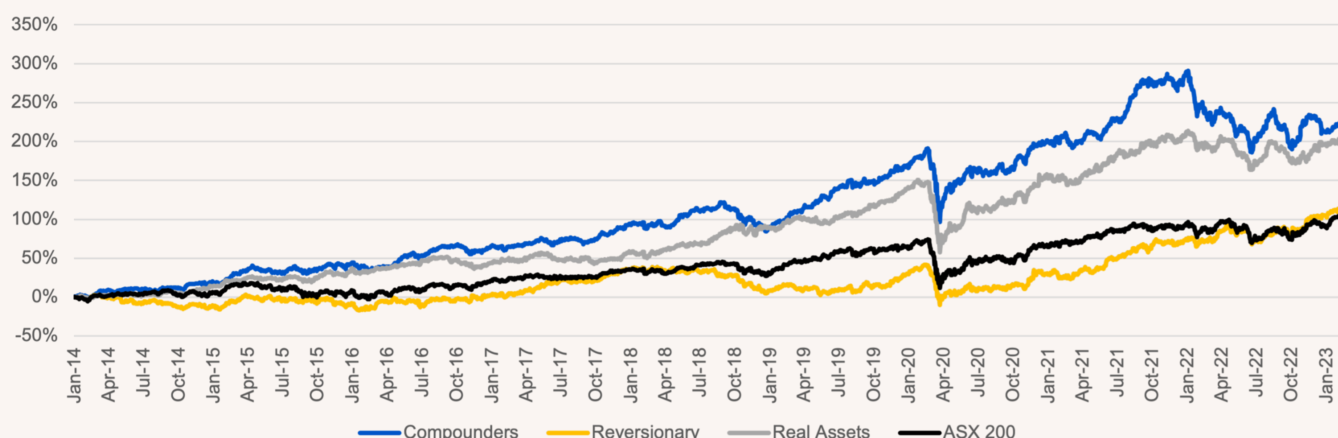
We see attractive levels of value latency across the portfolio.

We are observing operating trend inflections for many of our stocks which are under-earning and being capitalized on low to fair multiples. As a result, these companies have prospects for both multiple expansion and stronger than anticipated earnings growth. As mentioned, we also have a number of stocks exposed to potential corporate activity in which we are actively engaged to drive material value creation.

We are particularly excited about our Real Assets and Income capital pool, where we see significant risk adjusted latency, catalysts, improving operating trends and a strong proprietorial profile. Our exposure to the real asset capital pool has increased more recently as we seek to deploy more capital into our best risk adjusted ideas.

At a sector level, an area of disappointing performance has been stocks that are linked to property markets, most notably Lifestyle Communities (LIC) over the past 3 months, where the sharp changes in the cost of capital has driven lower earnings multiples and increased market concerns for both volume and price trends. We believe the medium-term outlook for these stocks remains strong as they all possess proprietorial overlays and target both affordable housing and the aged demographic; two sources of significant structural growth.

CAPITAL POOL PERFORMANCE



While Compounders have been the most challenged performance wise FYTD, as shown above they have historically contributed significant value creation to the fund.

Recent weaker performance has largely been driven by multiple de-ratings as risk-free rates have normalized albeit there have also been stock specific factors at play (RYM and TPG primarily).

However, we've still had strong performance from some compounders. As mentioned in the prior quarterly, Elmo (ELO), one of our high growth compounders recently left the fund via takeover. Late last calendar year we added Hong Kong listed Tencent (700-HK) given its strong growth profile, strong market positioning and attractive valuation, which at the time of our investment was trading at a low teen PE ratio once adjusted for its investments. So far, Tencent has performed well.

On the Reversionary side, the Fund's commodity and energy stocks such as BHP Group (BHP), New Hope (NHC, now sold), Origin Energy (ORG, now sold), and Woodside (WDS, now sold) have been strong performers across the year so far. In addition, commodity 'picks and shovels' such as Monadelphous (MND) and Orica (ORI) have also added value. We expect over the medium term, these stocks should continue to benefit from commodity inflation and growth in demand (volume).

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During the quarter, we added to our position in Australian Clinical Labs (ACL) prior to their result in February which subsequently beat market expectations. The company has since proposed a merger of equals with the #2 player, Healius (HLS), which we estimate has the potential to create >$1bn in value. The two main impediments to this value being realized are 1) how the value would be shared between the two company's shareholders and 2) ACCC risks given elevated combined market share in some locations.

Star Entertainment (SGR) has been the most significant detractor in the Reversionary pool FYTD. We have under-estimated the flow on impact from 18 months of regulatory challenges, significant Board and Management renewal, the potential for unexpected tax grabs and the opening of Crown Sydney while all of this is occurring. We thought we had been patiently observing, but in hindsight clearly not patient enough.

Finally, on the Real Asset side, European listed Ferrovial, which owns North American based tollroads and a share in Heathrow airport, as well as Infratil (IFT) and Brickworks (BKW), have been solid performers. Their quality assets and strong management teams increase the likelihood that the significant latent value that we observe will be realized.

OBSERVATIONS FROM THE ROAD

Our recent trip to NZ visiting a raft of companies and local banks highlighted an economy entering a state of flux with current economic conditions appearing surprisingly resilient in aggregate on the one hand while persistently elevated inflation and sharply higher interest rates tempered confidence in the outlook.

However, there was a clear delineation in positivity between the companies who are at the pointier end of the interest rate sensitive curve (property development, building materials) and the people intensive companies in contrast with the companies who are positively exposed to tourism and immigration/volume growth.

The cross-currents of these opposing trends apply similarly in Australia and have a number of investing implications in our view: 1) Observation not prediction takes on even greater importance in this environment; & 2) the risk mitigants from finding companies with positive operating, industry and focused management behaviour trends will be particularly valuable.

We suspect New Zealand may provide some early signals on how the Australian economic environment could unfold given the RBNZ has gone earlier and harder in raising interest rates.

It is somewhat intriguing that while the RBA paused its rate hiking earlier this month with the cash rate at 3.60%, the RBNZ hiked the cash rate by a larger than expected 50bps to 5.25%. While this divergence raises the risk that one of these central banks is making a policy error, it really underscores the reasonably high probability of a policy error when central banks have been so far behind the curve and have had to raise rates in an unprecedented manner.

Accordingly, we will continue to maintain regular dialogue with the New Zealand market as they could be the "canary in the coal mine".

During this trip we also attended Infratil's investor day. Infratil (IFT) sits within our Real Assets & Income capital pool and has demonstrated a long history of superior capital allocation (18.3% TSR over 20 years). The investor day again showcased Morrison & Co's (IFT's investment manager) internal ability to not only identify structurally growing and accelerating sectors early (data centres, renewables et al.) but translate these observations into building out value creating, scaled platforms in these verticals.

This platform focused 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) in which these returns continue to appear attractive while the incremental risk profile is lower as the "platform" (people, systems, IP, network et al.) is already in place.

The vital ingredient of also partnering with the right people with the right incentive structures was also reinforced as we listened to business founders across IFT's key verticals of Digital (Canberra Data Centres), Renewables (Longroad Energy et al) and Healthcare (Imaging).

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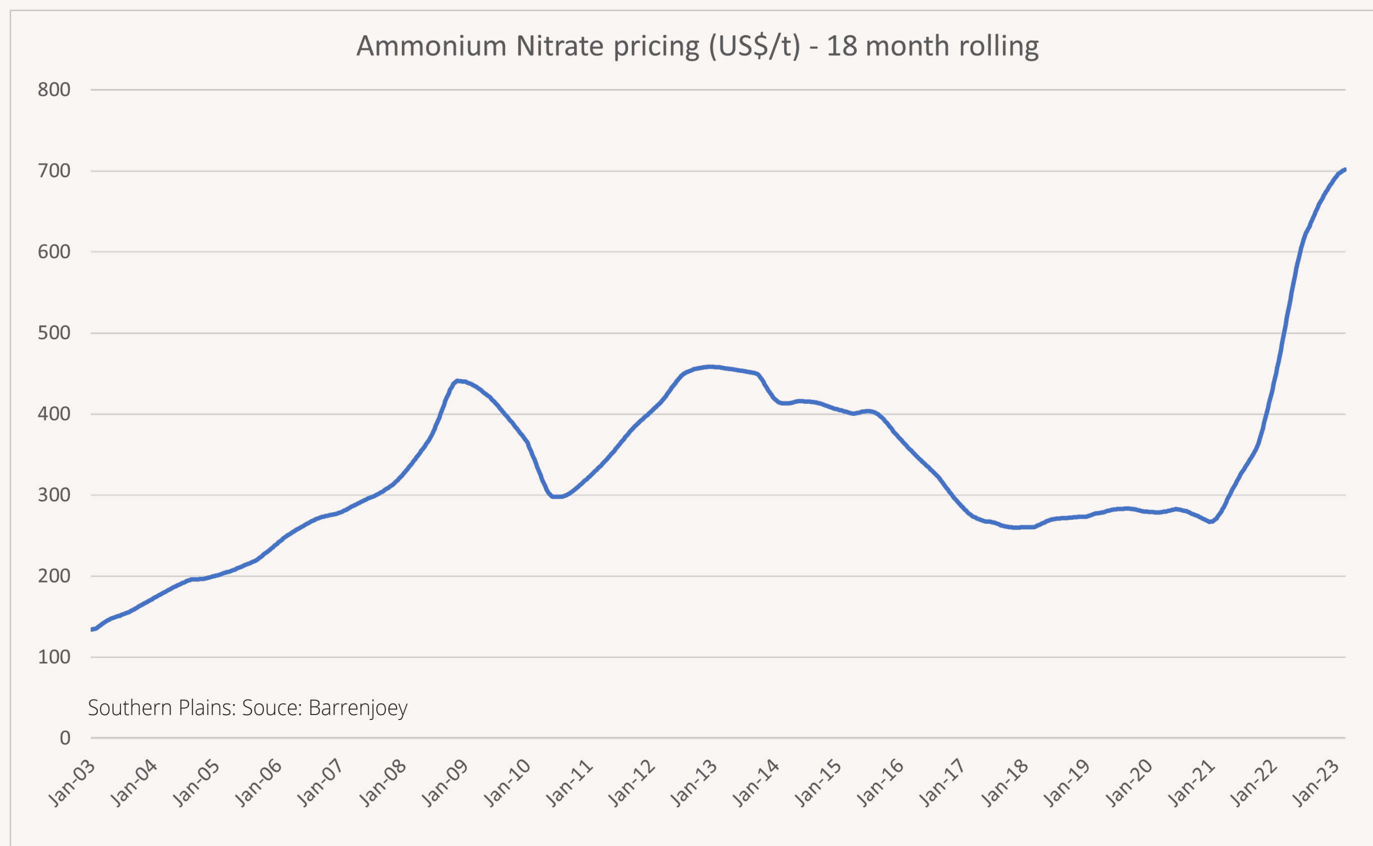
IFT's key mantra is pursuing "ideas that matter" and what we have come to appreciate is their ability to fully capitalize on these ideas once they have been de-risked and "proved up". This can be seen in their highly successful ownership of Tilt Renewables in Australia which then led them to invest in Longroad Energy, a developer, operator and owner of US renewable assets, which has generated even higher returns than Tilt did. Consistent with fully capitalizing on these "ideas that matter" where they have built genuine internal IP, they have also since created separate businesses in Europe, Asia and now Australia (again!) largely replicating Longroad's business model.

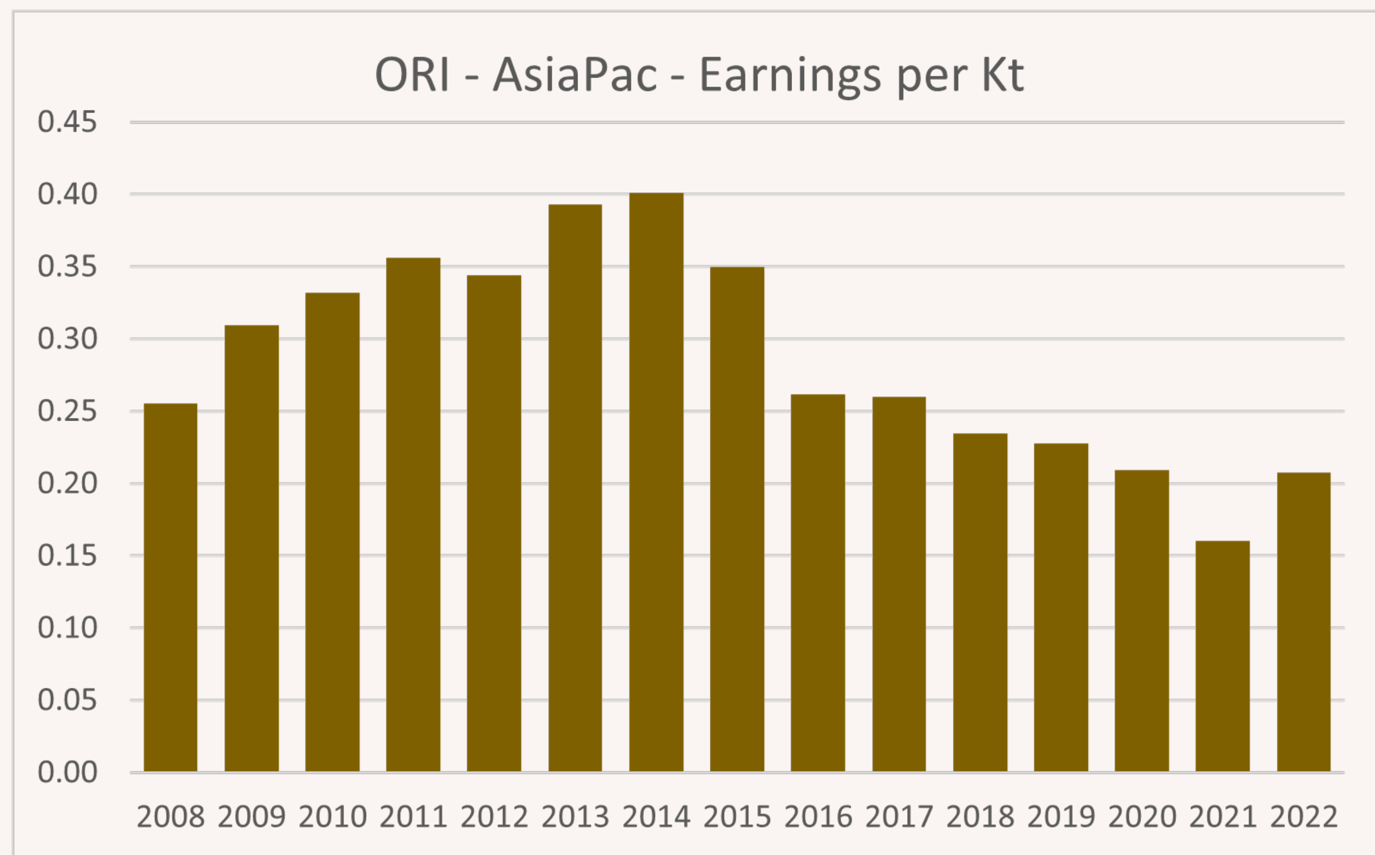
There are investing lessons to be gleaned from this approach for the Brunswick fund as we consider which verticals (affordable housing for instance) in which we have developed a strong investing framework, a network of best-in-class operators and the ability to leverage Cooper Investor's VoF observations from offshore markets which are more advanced than the Australian market.

Ultimately we came away from the investor day with reinforced conviction that Infratil and Morrison & Co have created a culture, an investment process and a framework for platform building which is systematic and enduring.

During the quarter, members of the CI research team visited Orica's (ORI) manufacturing operations in Peru and Canada. The team came away with increased confidence in the margin recovery story driven by improved internal commercial discipline and continued supportive industry dynamics (supply scarcity and improved pricing – chart below).



We continue to see a low-risk Reversionary opportunity in ORI as favorable Operating and Industry trends push earnings per tonne upwards from well below average levels (particularly in AsiaPac), while additional latency exists in monetizing their many years of historical product technology investment, monetizing SAP and earning an appropriate return on their Burrup facility in WA upon contract roll in ~18 months.



PORTFOLIO POSITIONING

We haven't made any significant changes to the portfolio but as mentioned we expect our exposure to Real Assets and Income to increase further.

The key areas of interest remain unchanged: aged accommodation, health products and services, housing and related sectors (US and Australia), supply chain logistics and infrastructure, telco and data infrastructure, inflation linked commodities, interest rate sensitive non-bank financials, everyday products and services, as well as various stock specific events or 'special situations'.

M&A also remains a key thematic. In the prior quarterly we spoke to our involvement in a number of situations, including where we are directly involved in progressing opportunities at the smaller end of the market. This involvement continues.

MARKET OBSERVATIONS

Most likely you have already read in detail about the Bank failures in the US and Switzerland which were significant and have led to a softening in the outlook for further interest rate increases. It is clear that in shifting the world from low rates, back to more normalized rates, there will be hiccups along the way. Until the tide goes out, it is hard to know exactly where the problems will materialize. However, it does suggest caution is warranted, but also that we should be ready for opportunities should they present.

Where we are observing genuine signs of stress is in the construction and development sectors with concerns also raised about commercial property across the US and Australia, given the combination of pressure on asset valuations (which are linked to the level of interest rates), rents (work from home etc) and higher debt costs, given leverage is material across the sector.

While there are numerous causes for concern which are discussed widely, it's worth keeping in perspective that Australia is fortunate to have firstly a valuable counter cyclical offset in a highly responsive floating currency and secondly there will be a powerful growth impulse over the next year from surging migration as shown below.

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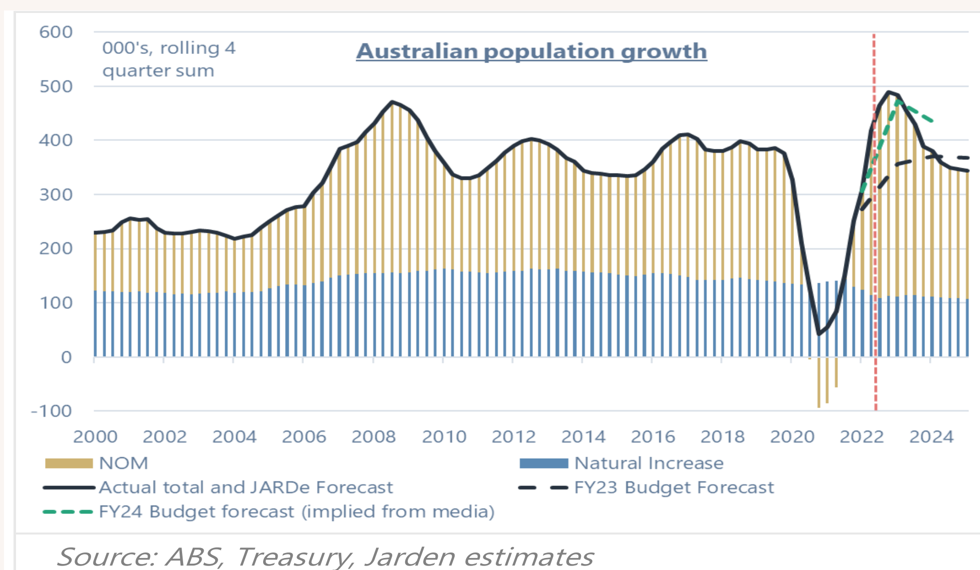

Source: ABS, Treasury, Jarden estimates

As Australia resumes its march towards a population in excess of 50 million people, the implication for the Brunswick Fund portfolio is that there will be many more Australians requiring (affordable) housing, insurance, childcare, freight logistics and insurance over that journey.

TEAM UPDATE

Stuart McLachlan, who joined Cooper Investors and the Brunswick Fund team in late 2018, has been made a Deputy Portfolio Manager of the Fund, recognizing his contribution to stock picking and performance during this period.

In addition, Gordon Lee joined the team during the middle of 2022. Gordon joined from Wesfarmers where he worked in the Corporate Development Team.

CLIENT RELATIONS

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