# CI BRUNSWICK FUND
## QUARTERLY COMMENTARY REPORT

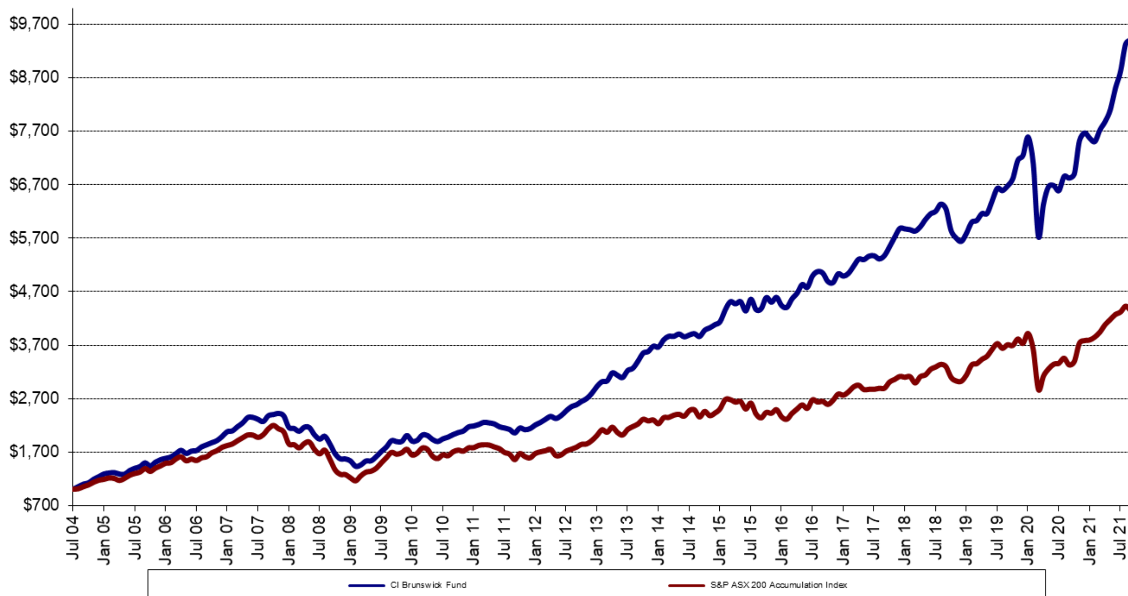
Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

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

## SEPTEMBER 2021

| | **PORTFOLIO | #BENCHMARK | VALUE ADDED |
|---|---|---|---|
| FYTD | 11.6% | 1.7% | 9.8% |
| FY 2021 | 28.6% | 27.8% | 0.8% |
| 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% |
| 10 YEAR* | 18.2% | 10.8% | 7.4% |
| SINCE INCEPTION* | 16.7% | 8.9% | 7.8% |
| SINCE INCEPTION^ | 1,332.6% | 334.4% | 998.2% |

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




Source: NAB Asset Servicing

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***"To become good at anything you have to know how to apply basic principles. To become great at it, you have to know when to violate those principles"***

**— Gary Kasparov**

***"All that matters on the chessboard is good moves"***

**— Bobby Fischer**

## The Brunswick Fund

| **Brunswick Fund Mission** |
|---|
| **1. Leverage CI's VoF stock research**<br>**2. Back proprietorial management**<br>**3. Allocate to 3 capital pools - Compounders, Reversionary & Real assets / income** |

The Brunswick Fund is differentiated by its ability to invest in a relatively unconstrained universe of small, medium and large ANZ companies and up to 25% International. 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**), which means we are not taking any more net external applications after taking into account redemptions and cash distributions, 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 Owner-Operator Cultures, and Specialist Focussed Managers.

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

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## Market and Portfolio Performance

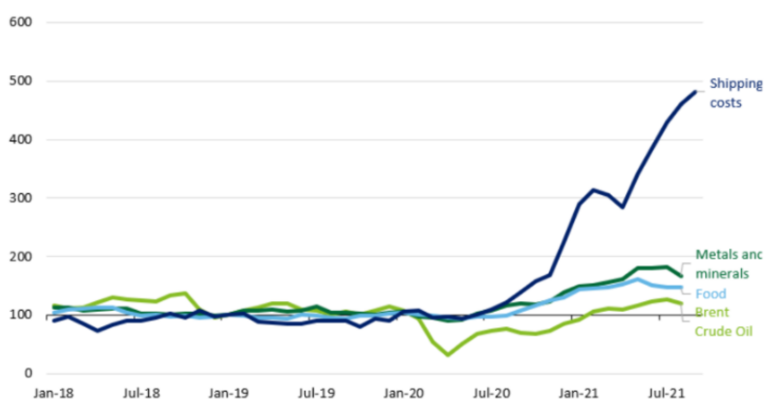
During the September 2021 quarter, the ASX200 Accumulation Index returned +1.7% and for the 12 month period to September 2021 returned +30.6%.

For the September quarter the portfolio returned +11.6% and +40.1% for the 12 month period.

Financial markets were volatile during the quarter. Global energy markets saw broad based inflation across oil, gas, coal and various other energy commodities. In part this was due to demand recovery as economies reopened, and in part exacerbated by systematic bottlenecks and regulation which has impacted supply. The UK experienced shortages of petrol and 'runs' on petrol stations. In addition, a one in one hundred year low in wind generation resulted in a spike in electricity prices and the failure of some UK electricity retailers. Gas storage levels also remain low, contributing to the spike in electricity prices and creating concern that current supply will be insufficient for the winter peak period. Gas prices across Europe have increased six-fold in just six months and in the UK have increased 3-fold (now at around $200 a barrel of oil equivalent).

Similarly in China, a recovery in manufacturing saw a material rise in electricity usage (~13%), contributing to a more than 5-fold increase in thermal coal prices globally, with shortages across China necessitating the rationing of electricity usage. Similar to the UK, the Chinese government now appears to be doing all it can to shore up supply for peak demand in winter (including accepting Australian coal which had previously been waiting at port).

In addition to the surge in energy prices, the pressure across the global trade and transport network saw ongoing increases in shipping costs which continues to feed its way through global supply chains:




Source: OECD, via Macrobusiness

These significant dislocations have created numerous investment opportunities for investors nimble enough to respond. The Brunswick Fund retains a number of exposures.

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## SEPTEMBER 2021

Key contributors to portfolio performance during the 3 month period include **Mainfreight (MFT)** (strong FY21 result, ongoing benefit from freight rates), **Z Energy (ZEL)** (takeover offer from Ampol) and **Lifestyle Communities (LIC)** (additions to pipeline).

Portfolio stocks that performed relatively poorly include **Reece (REH)** (de-rating as US growth takes longer to materialise), **Liberty Financial (LFG)** (increasing competition in mortgage markets) and **United Malt Group (UMG)** (ongoing challenges from covid-19).

During the quarter **Mainfreight (MFT)** provided an update on performance for the 22 weeks of the half (~5 of the 6 months) to end of August. The result was very strong with Revenue +43% and profit before tax +83%. While the prior period (April-August 2020) was impacted by the initial covid lockdowns, MFT's business is currently impacted by lockdowns in Australia and NZ, which have likely reduced transport revenues by ~30% (particularly in NZ).

Based on current observations, operating trends are likely to stay strong over the near term. In particular, the group's Air and Ocean business continues to benefit from tight capacity and a global surge in freight rates as demand has accelerated over the last 12 months.

**Liberty Financial (LFG)** reported its inaugural result as a listed company, delivering $226m of NPATA (net profit after tax pre-amortisation), a 61% increase on the prior year. The result was supported by solid underlying growth in its markets (mortgages, secured finance, other financial services), and a fall in both funding costs and bad debt losses following both government and central bank intervention in response to covid-19.

LFG was founded in 1997 by Sherman Ma, who had been consulting for McKinsey to one of the big 4 Banks. In doing so, he recognised an opportunity for a non-bank lender to offer mortgages to niche segments in the market, underserved by the big banks. Sherman retains a significant ownership stake and as Executive Director brings a proprietorship focus to the culture and management team of LFG (LFG sits in our "owner-operator culture" group of proprietorial managers).

Since its founding LFG has been able to grow its loan book well above 'system' (~4x system over the last 10yrs) via its niche focus and increasing scope. Importantly, this growth has been profitable/value creating, with returns on equity above industry underpinned by its risk-based pricing model and efficient operations. LFG does not require capital for organic growth (ie is self-funding). However, one reason for listing is to assist selective M&A activity going forward.

More recently, following house price growth of ~20%, Australia's banking regulator APRA has imposed new regulation to lift the serviceability buffer, in the hope this will impact the size of loans being written. APRA has previously utilised these 'prudential measures' to help curb lending.

However, as LFG does not utilise deposits for its funding, these regulations do not apply to LFG, or any of the other non-bank lenders. In prior periods this resulted in a significant shift in lending volumes to non-bank lenders.

We see significant value latency in LFG given the opportunity to grow market share in each of its core segments. LFG trades on a ~9x PE ratio and ~7% dividend yield, both of which are attractive relative to the 'big 4' banks.

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## SEPTEMBER 2021

**Home Consortium (HMC)** successfully listed its second REIT – **HeathCo (HCW)** – in August with ~$650m of capital raised. HCW owns property assets linked to the health, government and community services sectors. HCW was listed with a net cash balance sheet providing plenty of capacity to grow its assets over the medium term.

During the quarter HMC also acquired additional assets for its existing **HomeCo Daily Needs (HDN)** REIT taking its asset base to ~$1.8bn. HDN's property is strategically located across the east coast of Australia, with its tenants a mixture of non-discretionary retailers like supermarkets, as well as some speciality (neighbourhood) retailers and other service providers (for example GPs).

However, the parent group HMC continues to transition from a property owner /REIT, to a fund manager, targeting $5bn of FUM by end the of 2022, and $10bn by the end of 2024.

Some of this growth will come from adding additional assets to both HDN and HCW. In addition, HMC management, led by founder David Da Pilla, also outlined a plan to build out other asset classes over the medium term with the aim of a becoming a broader alternate asset manager of private equity, infrastructure and credit.

**Brookfield (BAM.A)** hosted an investor conference during the quarter highlighting:

- The group has delivered 20% p.a. shareholder returns for 20 years
- Over the last 5 years, its fee bearing capital is up 3x
- There is ongoing demand for alternative assets – alternatives were 5% of investable assets in 2000, are 30% now, and could get to 60% over the next decade
- It sees significant opportunities in private equity (growth focused), energy transition, and within its recent insurance spin-off.

BAM sits in our real asset and income securities capital pool, although it also has stalwart/compounding characteristics. We were attracted to BAM for its private capital qualities, and the way its proprietorial management and investor team has added value over long periods of time (i.e. the fact BAM management do all of the hard work on our/your behalf!). BAM is both an asset owner (property, infrastructure, renewables) and an asset manager (alternative assets).

We see value latency in BAM's balance sheet exposures (the separately listed trusts), in particular the recently privatised property trust BPY which BAM is now working through to optimise (for example by selling or repositioning various assets). In addition, BAM is generating significant cash within the asset management business. Industry trends for alternatives, real assets, and renewables remains very strong, and BAM has one of the best track records in terms of delivering investor returns. BAM is run by a long tenured team who continue to own 20% of the business.

During the quarter, **United Malt Group (UMG)** issued a disappointing update with Covid related issues in the Asia Pacific region detracting from strongly recovering trends in North America. In addition, the company disclosed a $16m provision for doubtful debt relating to a long-term Asian customer and a $6m provision relating to a Grain storage company entering insolvency in the UK. We had initially been concerned about small craft brewers struggling through on-going Covid lock-downs

in North America and were surprised that Covid reverberations had instead impacted other parts of the value chain.

UMG has built up a scaled global business comprising locationally advantaged Malting facilities supplying everyday needs products to bars, restaurants and pubs. Circa 65% of revenue is derived in North America, 20% in Asia Pacific and 20% in Europe. UMG's customers have been materially impacted by rolling global lock-downs and as a result we would expect UMG to participate in the recovery from Covid, however this recovery is unlikely to be a linear process as the company remains exposed to industry challenges from freight and logistics and barley availability given the poor harvest in North America.

During the period, **Z Energy (ZEL)**, received an acquisition proposal from **Ampol (ALD)** at an offer price of NZ$3.78 (~25% premium).

ZEL is a dominant (>40% of volumes and >50% of infrastructure), everyday needs business based in New Zealand which had been impacted by three industry events (regulatory review, refining margin collapse and covid-19), compounded by loss of focus of management, in particular in relation to recent non-core investments. We had originally established our position in ZEL as part of a capital raising conducted during Covid.

We increased our position in ZEL earlier this year as the company had made incremental operational and strategic progress which we didn't believe had been reflected in the share price. Operationally, this included continued cost-out, improved earnings momentum and greater intentionality on exploiting ZEL's powerful market share position.

Strategically, the company is exiting its exposure to refining which will release significant working capital ($150-200m) and reduce earnings volatility, is undertaking a Service Station REIT to release capital/increase flexibility and has increased its strategic focus on the non-fuels opportunity. When combined with the medium term prospect of a return to normality (broader mobility improvements and the resumption of jet fuel consumption) the confluence of these factors augurs well for very strong FCF generation and capital release over the next few years.

Two strong performers for the Brunswick Fund during the quarter were **Healius (HLS)** and **Australian Clinical Labs (ACL)**. This clustered exposure to Australian Pathology reflected an attractive combination of bottom up, top-down factors.

Our top down observations were that in other countries further along the Vaccination curve, Covid testing remained far more resilient than Australian analysts' forecasts assumed, industry experts were more positive on the durability of covid testing given logistical challenges in re-opening economies safely and that Pathology businesses have a high degree of fixed costs in which returns from incremental volumes are quite high. From a price per Covid test perspective there is likely to be downward pressure over time as we move further away from a containment strategy however this appears to be well captured within market expectations.

From a bottom-up perspective: Healius, which falls into our Reversionary category, demonstrated a strong re-focusing narrative with the divestment of the capital intensive Medical centres business during 2020, the intention to divest its Fertility business (recently sold but subject to ACCC approval) and the likelihood of divesting its Imaging business once it has been further optimized. Post these

divestments, HLS would primarily be a Pathology business; a particularly attractive industry to operate in especially as a scaled player (HLS: #2 mkt share) given high organic returns, solid industry growth rates, low capital requirements and strong FCF generation.

While Australian Clinical Labs is the number 3 player in the Pathology market in Australia, it is however a scaled player in the majority of States outside of NSW and QLD providing localized scale benefits. In prior years the company, under private equity ownership, undertook a significant laboratory information system overhaul which has contributed to very strong operating performance during Covid. The combination of structural efficiency and significant management intentionality and drive has resulted in the company generating exceptional incremental returns and cash flow in the past 6 months. Importantly, this leaves ACL with a very strong balance sheet to deploy accretively in the coming years as Covid testing volumes decline.

# 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 (49%)**
    - 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** (24% of the portfolio)
  - Sturdy, reliable and generally larger companies with world-class privileged markets and competitive positions. (Mainfreight, TPG Group)
- **Growth companies** (25%)
  - Growing companies with value propositions identifiable by traditional value metrics and run by focused, prudent and experienced management. (Lifestyle Communities, CSL)

2. **Reversionary sources of value – Cyclicals and Quality Turnarounds (32%)**
   - 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:
     - Quality companies impacted by the Covid-19 pandemic.
     - Cyclicals in the agriculture sector.
     - Cyclicals exposed to US housing.
     - Infrastructure privatisations.
   - **Cyclicals** (19%)
     - Stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. In other words growth cyclicals who can go to higher highs over multiple cycles. (BHP, Orica)
   - **Quality turnarounds** (13%)
     - Sound businesses with good management and balance sheets. We especially like spin-offs and government-to-private turnarounds. (United Malt, Z Energy)

3. **Real asset and income sources of value – Bond-Like Equities, and Asset Plays (17%)**
   - Stocks with specific risk and non-correlating attributes that make them very different to broader equity indices. All these securities are traded public securities. Our hope is these stocks will provide relative and perhaps absolute protection to the portfolio in times of monetary inflation, economic upheavals, and stock market corrections. Note: without hedging we cannot promise that outcome.
   - 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** (7%)
  - 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)

- **Asset plays** (10%)
  - 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, Infratil)

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 2% cash and has around 12% of assets invested in overseas stocks that own businesses in USA, Canada, and UK.

Portfolio attributes as at September 2021 are summarised below:

| P/E* | 19.59 |
|---|---|
| Beta | 0.81 |
| Yield | 2.86 |
| P/Book | 2.40 |
| ROE | 11.98 |
| Tracking error vs. ASX 200 | 7.73 |
| Stock Number | 36 |

*Note PE ratio distorted by Infrastructure stocks and some under-earning turnarounds and cyclicals.

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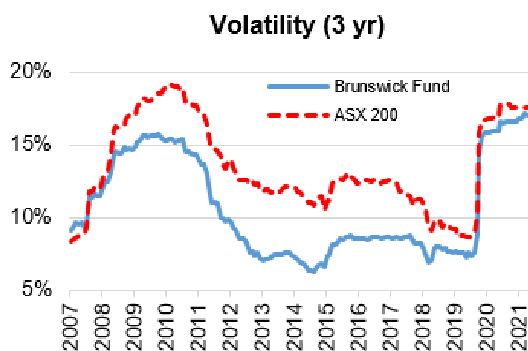
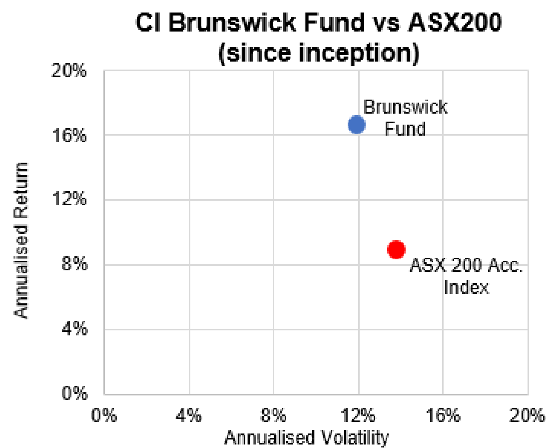
### Portfolio Risk Metrics

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 | +1,333% | +334% |
| Max Drawdown | -40.0% | -47.2% |
| Best Month | +10.9% | +10.2% |
| Worst Month | -18.9% | -20.7% |
| Positive Months | 69.6% | 65.2% |
| Negative Months | 30.4% | 34.8% |
| Annualised Volatility | +11.9% | +13.8% |

*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 April 2020, for the ASX200 Accumulation Index, it was November 2020.
Worst Month for both the Brunswick Fund and the ASX Accumulation Index was March 2020.



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