CI AUSTRALIAN EQUITIES FUND
QUARTERLY COMMENTARY REPORT

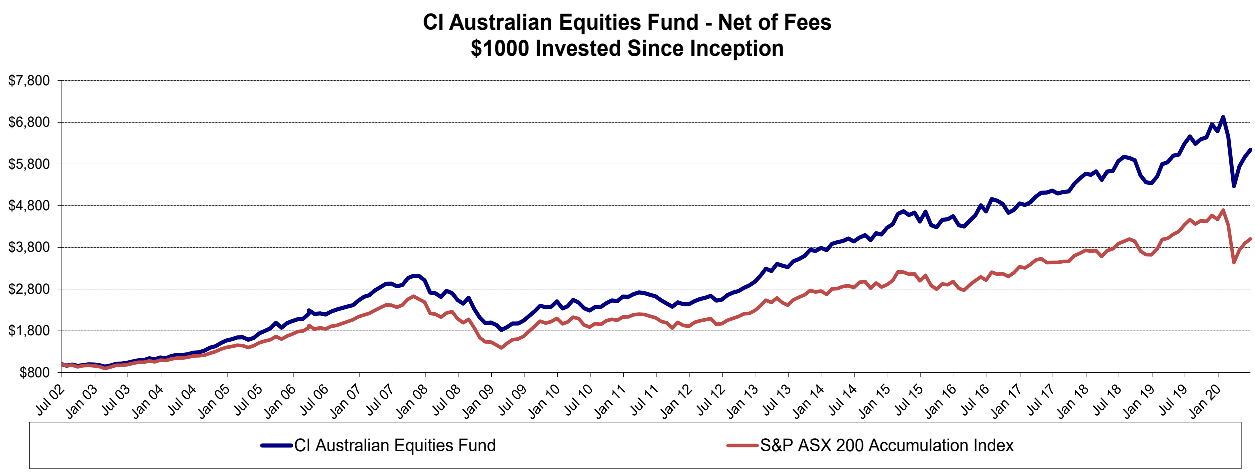
Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

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

JUNE 2020

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	16.86%	16.48%	0.38%
ROLLING 1 YEAR	-1.36%	-7.68%	6.32%
ROLLING 3 YEAR	6.80%	5.19%	1.61%
ROLLING 5 YEAR	7.80%	5.95%	1.85%
ROLLING 7 YEAR	10.27%	7.48%	2.79%
ROLLING 10 YEAR	11.44%	7.80%	3.64%
SINCE INCEPTION*	11.75%	8.01%	3.74%
SINCE INCEPTION^	638.07%	300.36%	337.71%

*Annualised
^Cumulative (4 July 2002)
**Before fees and expenses
#S&P ASX 200 Accumulation Index



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"Victory comes from finding opportunities in problems." ***Sun Tzu***

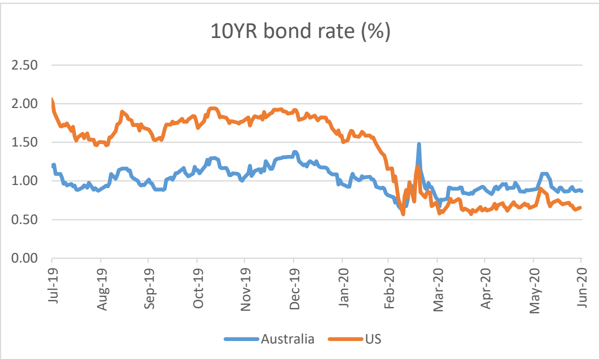
"It is during our darkest moments that we must focus to see the light." ***Aristotle***

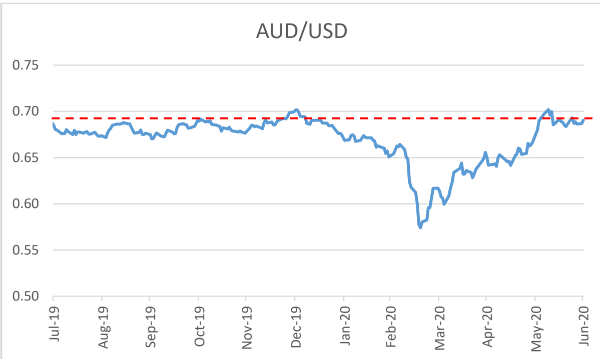
"Doing well is the result of doing good. That's what capitalism is all about." ***Ralph Waldo Emerson***

Market and Portfolio Performance

The ASX 200 continued its recovery trend throughout the June quarter, rising in each month of the quarter but finishing down 7.7% over the financial year. Recovery in markets globally was driven by the reopening and reactivation of economies, both China and the USA, supported by some of the most significant fiscal and monetary stimulus in history, and was not tripped up late in the quarter by a resurgence in infections in large parts of the USA. Australia, for the most part, has commenced the process of reawakening, albeit it is being held back substantially by some poor decision making in Victoria (which contributes approximately 25% of Australia's GDP). We are now approaching end of fiscal year "earnings season" in Australia – and would expect outlook statements for many companies to be particularly opaque!

Bond yields remain low and central banks are likely to keep them that way, which in part helps to justify current valuations in light of the significant earnings uncertainty facing most companies. The Australian 10YR bond yield is now back above the US again. The A$/US$ has ended the year relatively flat but it has been a volatile year touching as low as 0.55 mid-March before rallying strongly with the market recovery. Oil prices have also recovered from their US$20 per barrel lows to around US$40 per barrel currently, albeit they are still well below where they started the year in the mid-US$60 per barrel range.





Source: IRESS

Better performers over the quarter included OZ Minerals (start up at new mine Carrapateena seems on track, and copper price recovery), Santos (oil price recovery) and Seek Limited (partial job ads recovery – but there remains some water to flow under the bridge in this area given the current Covid 19 affected economy). Stocks which did not perform as well included CSL (restrained ability to collect plasma in the USA will likely have a short term impact on earnings in FY21), Brambles (economic softness will likely impact earnings in FY21) and Telstra (did not participate in the market rally).

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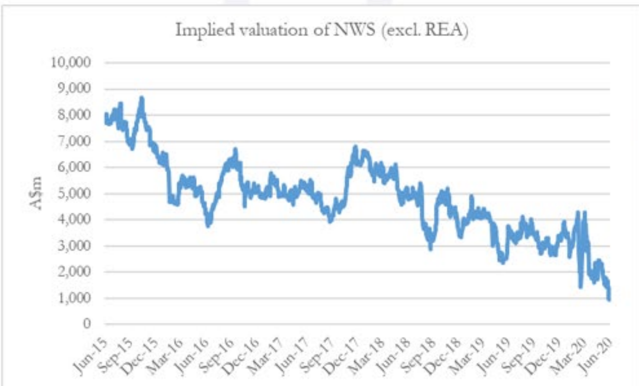
Amcor (AMC) reported its third quarter profit during the period, and in so doing was one of the very few companies to upgrade its earnings forecast for this fiscal year as synergies from its acquisition of Bemis come through a little quicker than anticipated. AMC's main exposure is to the food and beverage industries so, although it has exposure to Latin America (where Covid has had a major impact on economies), its volumes and revenues have proved to date to be steady. Food packaging has assumed greater importance during the pandemic and the major environmental issue around plastic packaging has gone off the front pages temporarily. We believe that as the largest global player in the industry, AMC is well placed to innovate and invest to find a solution to the recyclability issue for plastic packaging.

CSL had a busy end to the year with a number of announcements on the acquisition and management front. In early June CSL announced it had agreed to exercise its right to acquire Vitaeris which CSL has had a strategic partnership with since December 2017. The partnership has been working on a treatment for rejection of solid organ kidney transplant patients (Clazakizumab). CSL noted the acquisition price is modest and will not change FY20 profit expectations, however there will be additional R&D expenses of US$30m-US$50m in FY21. This transaction adds to CSL's emerging portfolio of products in late-stage development to address unmet needs in the transplant market, which is estimated to be a US$750m revenue opportunity.

In mid-June CSL announced the resignation of CFO David Lamont effective from 30 October 2020 with a global search commenced for his replacement. David has been appointed CFO at BHP effective 1 December 2020 and will also join their executive leadership team. This is disappointing for CSL as David has been a commendable CFO for the company. In late June CSL announced it had agreed to acquire from UniQure the exclusive global rights to commercialise a gene therapy program (AMT-061) for the treatment of haemophilia B. CSL will make an upfront payment of US$450m followed by regulatory and commercial sales milestone payments and royalties, which we understand will take the total acquisition price up to US$2b. This gene therapy product will be highly complementary to CSL's existing product portfolio and is strategically sound as CSL is acquiring a technology that has the potential to be very disruptive to their existing haemophilia B franchise.

We have been long-term shareholders in News Corporation (NWS) and remain disappointed that the significant latent value in the business has not been unlocked. While Foxtel and parts of the News and Information Services business have been a drag on the group performance in recent periods, this is far outweighed by the value inherent in its portfolio of quality assets including realestate.com.au (REA) (61.6% ownership), Dow Jones, book publishing and Realtor (US online real estate portal business). To illustrate this, REA's percentage of NWS' market capitalisation has increased over the last 5 years (using the see through value of REA's share price), which implies that the valuation of all the other assets has declined materially over the same period. The New York Times which is a close comparator to Dow Jones, has performed strongly over the same period (+~200%). While some progress has been made to simplify the business, we believe a lot more can and needs to be done and we will continue to engage with both the board and management team to unlock this value.



Source: Factset

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The Portfolio

As per our last quarterly, it seems appropriate to again remind both ourselves and our clients of our reason for being, and why we are confident the quiet but resolute application of our philosophy and process will continue to be successful. We most certainly cannot predict the future, and even less so the next six to twelve months. Our focus is on the medium to longer term time horizon over which period we look to back management teams with the capability, opportunity and ambition/intentionality to add value over that time frame. The VoF process is a values driven pattern recognition system to identify, from company operating trends, industry structure and company strategic position, the best risk adjusted investment opportunities.

Although we are not top down managers we do recognise that portfolios exist in a context and framework of externalities which provide both opportunity and threat. The following "big picture" themes are among those we would consider relevant:

- The enormous quantity of debt now everywhere (government, corporate and household/personal), and the "financialisation" of western economies which needs to be unwound if interest rates are to normalise. This is unlikely to occur quickly, implying a long period of very low interest rates which in turn has implications for bank profitability and their ability to foster economic growth through lending;
- In addition, at least in the short term, the banks are being used by the government as economic shock absorbers as they defer the need for borrowers (SME and mortgages who have borrowed close to $240B) to repay loans for an additional four months (now totalling ten months of deferment). The accounting and capital treatment of these deferrals is of course fanciful and will not reflect the true state of affairs – how the bad debts profile for the banks resolves at the end of this period is not clear;
- The growing level of government involvement in both the corporate and personal sectors – both from a regulatory perspective, but also the seeming inevitability of increased taxes to pay both for government largesse during the Covid 19 crisis, as well as for redistribution to balance the "wealth inequality" that the last few decades of rising asset prices has spawned;
- As a result of the above points, as well as the lessons of the last two crises (GFC and Covid) consumer behaviour and spending habits are likely in our view to revert to greater levels of thrift and frugality;
- The Chinese economy, Australia's relationship with China, and more generally the position of China in the world – its importance to Australia (resources, agriculture, tourism, property, education) cannot be underestimated;
- As we exit from Covid 19 what will be the impact on residential, retail and commercial property – will living, working and shopping habits have changed sufficiently to have meaningful and lasting impacts on property demand and values.

At the end of the quarter the portfolio remained underweight the bank sector for reasons we have espoused on numerous occasions. Major banks' return on equity has faded from high teens to circa 10% today and it is hard to imagine in the short to medium term circumstances in which prior levels of profitability will return. Banks in Australia are for the time being effectively an arm of government being used to prop up the economy – the risk is that this situation becomes at least semi permanent. We remain underweight the property sector given difficult operating trends in most categories of property, albeit that low interest rates will likely put a lid on any rise in cap rates. A number of the property names have taken valuation write downs recently and with stocks trading at discounts to NTA, investors are anticipating more to come. We also remain underweight bond like equities – interest rate impetus to valuations has now faded and the level of gearing carried in the current environment make us cautious. We are overweight stalwarts - sturdy, reliable and generally larger companies with world-class privileged markets and competitive positions (eg. Cleanaway, ASX, Brambles, Woolworths). We believe these companies, while far from immune to the impact of Covid 19 in the short term, have opportunities over the medium to longer term to create value for shareholders.

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During the quarter we added a small position in **Lendlease (LLC)** to the portfolio. Founded by Dick Dusseldorp in 1958, LLC is a global integrated development, construction and funds management business operating in 15 countries across Australia, Europe, the Americas and Asia. Over the past 60 years, LLC has been entrusted with many projects of public, cultural and social significance including constructing the Sydney Opera House, creating the National September 11 Memorial & Museum in New York, and restoring and renovating historic buildings such as London's Tate Britain and National Theatre.

The core business focusses on mixed use urban regeneration in select gateway cities. Whilst facing short term operational headwinds as a result of coronavirus, the opportunity set in the core business is large and growing. The ~A$112bn development pipeline is equivalent to ~25 years of development work at current production rates with the opportunity to increase rates of production by 50-100% over the medium term as LLC continue to build out global development capability. This pipeline includes ~A$50bn of investable assets providing a platform for LLC to more than double funds under management over time. The non-core Engineering business has had numerous issues since it was acquired in December 2010 and has detracted from what is a strong core business. In Dec-19, LLC announced an agreement to sell this business to Acciona. With FIRB approval having been granted and progress being made on client approvals, the transaction is expected to complete in early FY21. In addition, following the $1.2bn equity raising in April, management expect gearing to be below the bottom end of the target range of 10% with total liquidity of >$5bn at 30 June 2020 providing LLC the flexibility to take advantage of investment opportunities that may arise coming out of the pandemic.

While we are attracted to the opportunity for LLC (it is clear and large), we remain disappointed in the focus and intentionality of both management and the board to get to grips with the opportunity and execute in an efficient and profitable manner. They have drifted off course way too often (North Connex, Melbourne Metro Tunnel, Kingsford Smith Drive) with little to no accountability taken at board or management level for the shareholder losses thereby incurred. Complexity around the company and its operations remains high. We also believe the level of debt in the company has been too high given the cyclical nature of their underlying asset class. As a result the price we paid to enter the stock in the recent placement ($9.80 and a 15% discount to net asset value) is the same price at which the stock was trading in September 1996. Clearly changes are needed to ensure shareholders are rewarded with more than a flat share price over the next twenty four years. Companies operating in similar fashion to LLC over this period and which have built large and successful operations in the way LLC has proved unable to do to date include Macquarie Bank and Goodman Group.

We added to our position in **Ampol (ALD)**, formerly Caltex (CTX). Whilst Convenience Retail volumes were severely impacted during nationwide stage 2 and 3 restrictions, industry retail fuel margins where favourable and management used the weak refining margin environment to bring forward and optimise the planned Lytton refinery turnaround and inspection. As operating conditions improve and financial markets stabilise, ALD is well placed to execute on the property IPO / trade sale and accompanying capital return and is engaging with the Australian government as to how the asset base could be involved in establishing a national oil reserve.

At the end of the quarter, ALD appointed Matthew Halliday to the permanent position of Managing Director and Chief Executive Officer (MD&CEO), a position he has held on an interim basis since March 2020. Since his appointment as CFO in April 2019 we have had numerous discussions with Matthew on various strategic initiatives including the retail network review, the proposed property IPO / trade sale, cost out initiatives and other organic growth opportunities. In our view, Matthew brings a refreshing, returns focussed perspective to the business with the intentionality required to extract the value embedded in the asset base and we are pleased to see him appointed to the CEO role on a permanent basis.

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Qube (QUB) raised $500m through an entitlement offer, which we participated in. We have been long-term shareholders in QUB and continue to support management's vision of becoming Australia's leading provider of integrated logistics solutions focused on import and export supply chains by investing in strategic assets and sites. Prior to the equity raising, QUB's gearing was at the mid-point of their long-term target range of 30-40%. The raising will reduce gearing well below their target range and provides them with the flexibility to continue to invest in their business, mainly on the build-out of the Moorebank Logistics Park, and be positioned for strategic acquisitions that may arise in the current environment.

Towards the end of the quarter, QUB also announced that Woolworths (WOW) will become a major tenant at the Moorebank Logistics Park. QUB will fund the construction of both national and regional distribution centres on behalf of WOW in return for a long-term lease (20 years with 6 x 5 year options). For WOW, they will be consolidating three existing sites into these two highly automated facilities that will improve efficiency and reduce truck movements. This is very important for QUB given it validates the significant competitive advantages at the Moorebank site, and we expect this agreement will bring forward negotiations with other potential tenants on the site. QUB is continuing with its monetisation process for Moorebank and other property assets in the portfolio.

During the quarter we exited our position in Ramsay Healthcare (RHC) having participated in both the Paul Ramsay Foundation sell down and the April capital raising during the COVID-19 pandemic. The positon was initiated in September last year when the Paul Ramsay Foundation announced the sale of part of its stake in RHC at $61.80 per share. Then in April, we furthered our position by participating in the RHC capital raise at a price of $56 per share. The intention of the equity raise was to strengthen the balance sheet and allow flexibility for possible M&A opportunities that arise out of COVID-19. We took the opportunity to participate in the sell down and the capital raise as at these prices the stock offered value latency in a stalwart business. We decided to exit our position as we are conscious that the prolonged nature of the COVID-19 pandemic may further exacerbate some of the headwinds we are witnessing in the domestic healthcare market (Asia Pac ~70% of RHC FY19 earnings). Most notably, we expect some earnings pressure to come from increased hospital costs relating to COVID-19 protection measures, as well as both short and medium term pressures on Private Health Insurance uptake and product affordability in the face of a weakened economic back drop. We do not see enough value latency in today's prices to compensate for the above risks longer term.

There have been 61 raisings in in the ASX 200 since Covid started raising a total of $27,996m. We have referred to a few in this report, and in our March report, in which we participated in order to establish or build on positions in companies we have had under watch. In addition we took part in raisings in other companies (Flight Centre, Auckland Airport, Newcrest Mining) which we have elected to sell in the more immediate aftermath of the raising in light of the share price performance (+25-30%) which gave us our assumed two or three year return in a matter of weeks. We have been selective in the capital raisings that we have participated in, only seeking to take positions in those companies that offer clear value latency with longer term value creation opportunities.

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