CI AUSTRALIAN EQUITIES FUND
QUARTERLY COMMENTARY REPORT

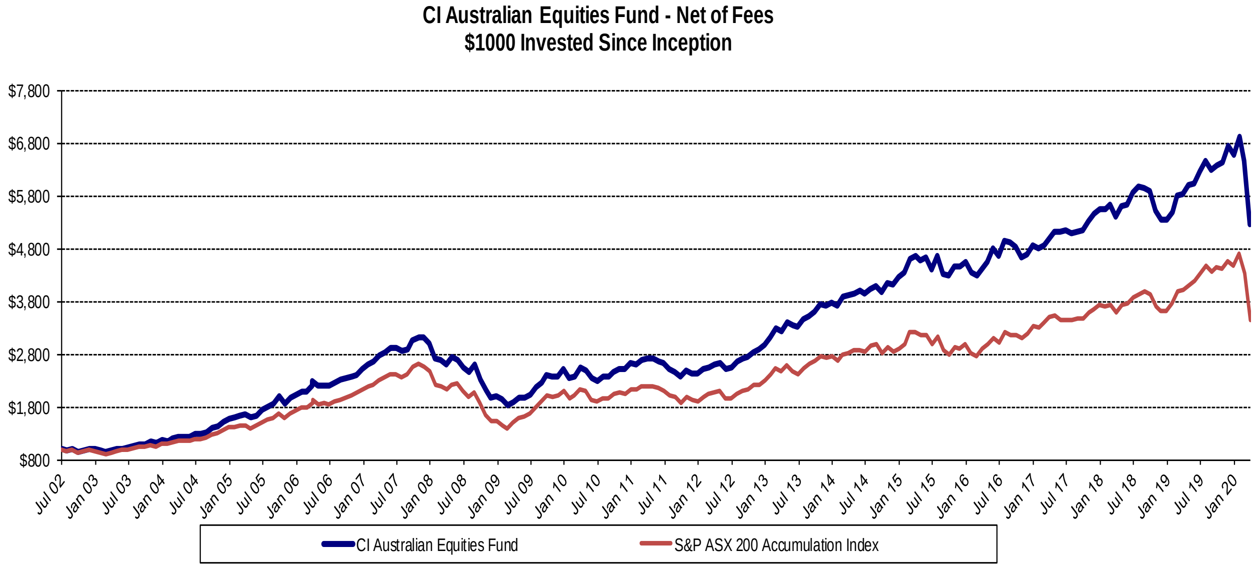
Cooper Investors Pty Limited | AFS Licence Number 221794 | ABN 26 100 409 890

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

MARCH 2020

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	-19.89%	-23.10%	3.21%
ROLLING 1 YEAR	-9.15%	-14.42%	5.27%
ROLLING 3 YEAR	2.46%	-0.56%	3.02%
ROLLING 5 YEAR	3.41%	1.39%	2.02%
ROLLING 7 YEAR	8.36%	4.79%	3.57%
ROLLING 10 YEAR	8.59%	4.92%	3.67%
SINCE INCEPTION*	10.95%	7.21%	3.74%
SINCE INCEPTION^	531.56%	243.72%	287.84%

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



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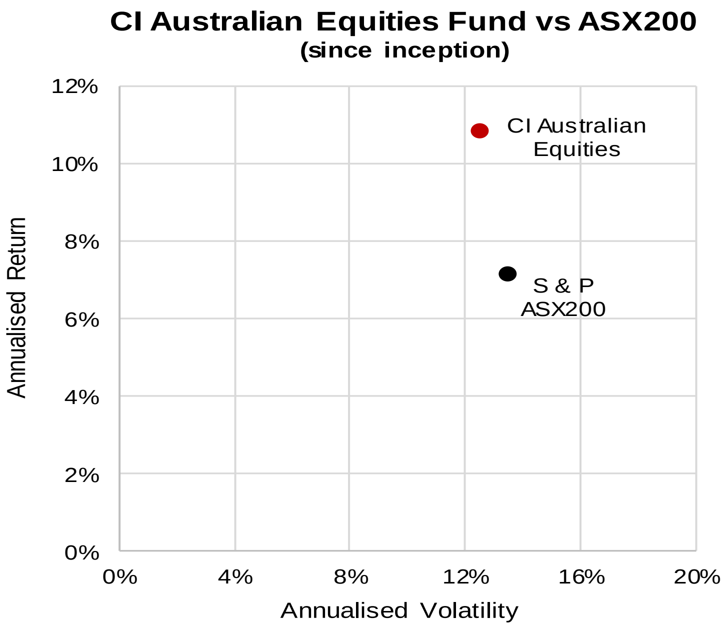

"A desk is a dangerous place from which to view the world." John le Carre

"A leader has the right to be beaten, but never the right to be surprised" Napoleon Bonaparte

"The whole future lies in uncertainty: live immediately." Seneca

"Be a master of the mind, not mastered by the mind." Zen proverb

"In the field of observation, chance favors only the prepared mind." Louis Pasteur

Market and Portfolio Performance

At the end of a quite remarkable quarter, and having been down over 30% at one point, the ASX200 finished 23% below where it started the calendar year. The single most obvious reason is the Covid 19 virus now sweeping the world, for which those in power in the Western world were woefully underprepared and late to the party. In light of the widespread social and economic impact of the virus, it is not surprising that there was large disparity in sector/industry performances. Unsurprisingly the best performers included healthcare, consumer staples and utilities, while the worst were energy (not helped by an unfortunately timed disagreement between Russia and OPEC on oil production cuts), financials and real estate.

Better performers in the portfolio included ASX Ltd (large rise in market volatility and volumes will likely drive a strong FY20 result), CSL (strong half year result and will escape relatively unscathed from the current crisis) and Woolworths (large increase in demand). The main detractors from fund performance included Santos (oil price collapse), Computershare (falling interest rates – now unlikely to be able to fall further – led to earnings downgrades) and Bluescope Steel (anticipated fall in demand and thus steel spread).

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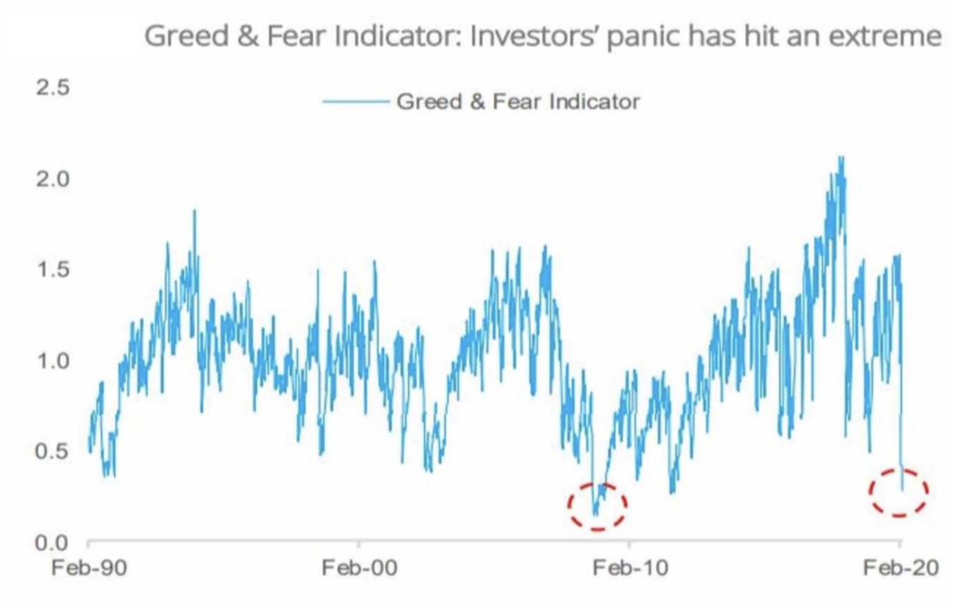
MARCH 2020

In our December quarterly we commented on the rise in the PE ratio as a major driver of the rise in the market over 2019. It remains to be seen the extent of disruption to market earnings overall over the course of the next six months, but there is little doubt aggregate earnings will fall. Some companies will see revenue (and therefore earnings) fall to almost zero (eg. travel agents, airports, airlines, discretionary retailers) for a period of time, while even those companies exposed to an increase in demand (eg. food retailers) will see increases in both cost to serve (supply chain, in store labour) as well as increased cost generally (staff health related costs). There will be very few companies who do not experience an adverse impact of some nature from the current circumstances. The charts below would indicate the market has, at least partly, discounted the next 6-12 months of earnings falls.



Greed & fear indicator: investor's panic has hit an extreme. **Bloomberg, DBS**

Source: MST Marquee

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

MARCH 2020

The Portfolio

In this time of rapid and uneasy upheaval, it seems appropriate to 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 are specialist large cap Australian equities managers allocating capital to the best risk adjusted value latency (RAVL) opportunities at any given time. We run a concentrated portfolio with meaningful active positions. Our time horizon is 3-5 years and we look to back management teams with the capability, ambition and opportunity 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 RAVL investment opportunities.

We do not know for sure what is coming, and indeed there is little point in giving you our guesses as to what might or might not precipitate a move towards resumption of more normal life, or when it might happen. There are plenty of pharmaceutical companies working on solutions to Covid 19, and in all likelihood one of them will find a way forward. So we can be confident that when all is said and done we will emerge on the other side and when we get there, there will be change, and in that change will lie opportunity. As Mark Twain is reputed to have said “history doesn’t repeat itself but it often rhymes”. And it may take time for such change to become obvious. We remember the 1987 market crash and dislocation, after which it took 2-3 years for the property market to come unstuck in a very nasty fashion. We fervently believe acute observation will stand us in good stead in this regard. Indeed we have rarely been busier, having spoken to all our portfolio companies (some on multiple occasions) and many others over the last four weeks. In particular, communication technologies which we have not had to use in the past have very much come to the fore (Webex, Zoom, Microsoft Teams, Blue jeans et al).

Some of the areas which may give rise to opportunity (and look a little like history) as we emerge from the current environment include:

- A back to basics conservatism in consumer and essential needs
- Government partnership in light of the now hugely more extensive government involvement in the economy and society
- Recapitalisations (in which we have already participated) as over leveraged companies seek protection from the impact of current circumstances
- Greater nationalism and the resurrection of self-sufficiency in Australia, and the greater importance of local infrastructure
- Government indebtedness and likely government to private asset sales, and the avoidance of areas where greater tax imposts and levies may appear
- Changes to global supply chains will give rise to winners and losers
- Technology, communication and data as automation, work from home and the cloud become a way of life

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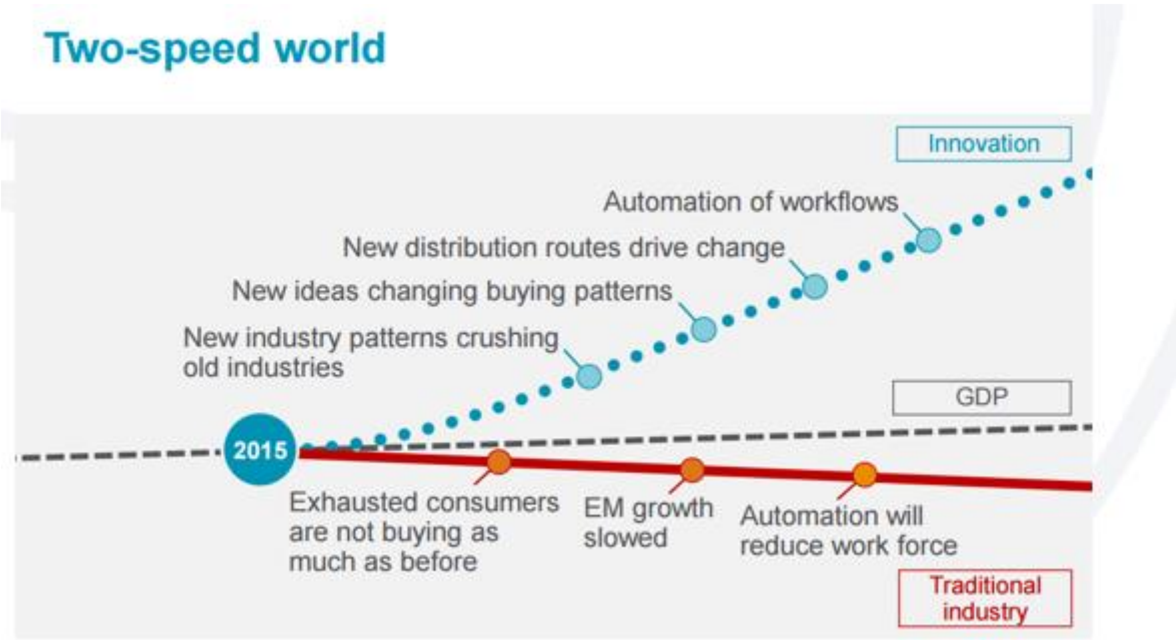
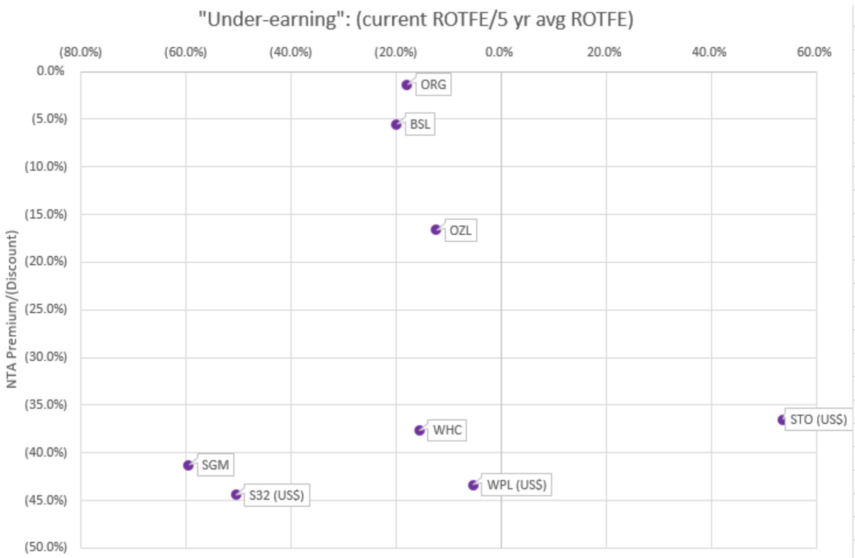
MARCH 2020



Source: Hexagon Capitl Markets Day 2015

- Digital strategies of different companies and industries – the tech bust of the year 2000 laid the way for the giants of today who successfully used the internet as a pathway
- The value of different types of real estate and ability for smart managers to add value in each area – the last property bust in Australia was in the early 1990s and todays empty/shut retail tenancies mirror some of the office blocks of thirty years ago, while the GFC heralded a major residential downturn in the US
- Companies trading below the intrinsic value of their assets



Source: Factset

MARCH 2020

Having written about the banks in the December quarterly, we further reduced our weighting in the sector in the latest quarter. Operating trends continue to get worse, and while now becoming part of the solution to the current economic disruptions (as opposed to the cause as was the case in the GFC) the part they play will come at a cost.

We also reduced our position in Seek – sadly far earlier than we had anticipated doing. The government moves to shut down the Australian economy were clearly going to wreak havoc on job advertisements as companies went from hiring to laying off staff, and therefore have an impact on Seek's cash flows. While we remain confident on the medium term future for business, and indeed the Chinese business is slowly emerging from its cathartic moment, we are discomfited by the level of debt carried by Seek in such an uncertain environment.

The cash generated from reducing our positions as per the above was reinvested in the following stocks:
We initiated a position in **Telstra (TLS)**. We took the opportunity in the stock and market sell-off to establish our position. In the short term the company's defensive cash flow characteristics and re-based dividend of 16cps (fully franked) should the position the company relatively well in an uncertain period ahead of us.

In the medium term our investment proposition is driven primarily by two key factors. Firstly, the operating trends in the mobile market, which remains Telstra's crown jewel, have improved. Telstra's peers had been pricing aggressively and investing in sports content to grow market share. The market was also positioning for TPG Telecom to enter the mobile market as a fourth mobile operator, now not the case given they have been cleared to merge with Vodafone. The result of all of this was lower pricing across most price points and very generous data inclusions. We have recently seen rationality return to the market with price points across the key post-paid pricing tiers increase and less discounting. We are also watching the continued development of 5G to determine whether it will deliver incremental returns to the mobile operators. It is worth noting that Telstra is leading on this front.

Secondly, we think Telstra is on the right path with its T22 strategy which involves a significant cost-out programme, simplification of systems and products, extending their leadership in mobile and setup of InfraCo. This strategy will go some way to offset the cost headwinds it faces from their customers migrating over to the NBN of which Telstra has absorbed about 60% at the end of 1H20. We think the setup of InfraCo is important as we believe there should be meaningful value latency if management can realise the inherent value of the assets that sit in the newly formed structure.

During the quarter, we also added **Santos (STO)** to the portfolio. STO is an oil and gas exploration and production company with a portfolio centred around 5 core, long-life natural gas, liquefied natural gas (LNG) and oil assets across Australia and in PNG. STO operate 4 of the 5 core assets being Western Australia, the Cooper Basin, Queensland and NSW and Northern Australia whilst ExxonMobil operate PNG LNG of which STO has a 13.5% interest.

Since 2016, STO has executed the first phase of its transform, build and grow strategy leaving the business much better placed to navigate a sustained period of supressed oil prices. The internally funded operating model relies on each of the five core assets having a free cash flow (FCF) breakeven well below US$40/bbl, with the business units encouraged during normal oil price environments to purse exploration within the US$40/bbl limit. This operating model combined with the fixed price, CPI linked gas business in WA (~35% of sales volumes) creates a diverse, low cost, resilient business. In conjunction with oil price hedging for FY20 (~10% of FY20 sales volumes at ~US$43/bbl) management is targeting FCF breakeven of ~US$25/bbl whilst maintaining production guidance of 79-87mmboe.

Furthermore, we believe STO has significant value latency opportunity in a broad, diverse growth pipeline predominately at STO operated assets. We back management to execute on these projects over a number of years once the operating environment improves. These projects include Barossa gas field backfilling Darwin LNG, Dorado oil development in WA, the Narrabri gas project which could supply up to half of NSW's natural gas needs, LNG and gas processing infrastructure monetisation and PNG LNG expansion amongst others.

Importantly STO are taking a pro-active approach to responsible investing and their impact on global greenhouse gas emissions. They are pursuing a number of initiatives that are promising and have value uplift potential, the largest of which is a 1.7mtpa Carbon Capture and Storage project in the Cooper Basin. This project is targeting FEED during 2020 and management believe it is a scalable opportunity with up to ~20mtpa of CO2 storage potential.

We have recently been building a position in Australia's leading supplier of bathroom and plumbing products, **Reece** (REH). We took the opportunity to further embed our position by participating in the company's recent A$600 mil capital raising via a non-renounceable rights issue and placement.

As part of its overseas expansion strategy, REH acquired Morsco in the US in 2018, funding this via a combination of debt and equity (as well as a more recent follow-on acquisition). Although not extended, Reece's balance sheet was fully geared prior to the recent raising. Before it acquired Morsco and under the long-term guidance of the Wilson Family, REH's gearing had been very low (net cash), particularly given REH owns a lot of the property where its stores are located.

To date, REH's business has not been materially impacted by COVID-19. Plumbing is still an essential service. However, stage 4 lockdown in NZ has seen sales in the country fall more significantly (NZ is a small contributor overall to REH). The additional $600m of liquidity will ensure REH can comfortably survive, even in an extreme case where stage 4 lockdown lasts across all its geographies until the end of CY21.

Reece is the dominant player in the Australia plumbing market. We expect Reece will be able to win market share through any downturn. In the US, the Morsco/Reece business is still early days in terms of its development (albeit the underlying businesses such as Morrison Supply have been operating in the US for over 100 years). We do expect that from a position of relative strength, Reece are very well placed to continue to grow their business both here and in the US.

During the quarter we added **Altium** (ALU) to the portfolio. ALU is a global leader in the development of Printed Circuit Board (PCB) design software. PCB's are a physical component that exist in almost every electronic device today (smart phones, computers, cars). ALU's PCB design software offering leaves it well positioned to take advantage of one of the most favourable structural trends in the world – the growth in the Internet of Things (computing devices embedded in everyday objects).

Founded in Tasmania in 1985 and listed on the ASX in 1999, the company's dedication and focus on product development has led to the proliferation of its design tools globally (revenue split 45% Americas, 36% EMEA, 19% Asia Pac). ALU management have now set themselves the challenge of taking their current ~50k PCB subscriber base to 100k by 2025.

In addition to continued growth in the core PCB design product subscribers, we feel there is further value latency in adjacent opportunities the company is pursuing. Firstly, ALU has entered a strategic partnership with Dassault Systèmes, one of the world's largest software solutions providers. Commercial terms are currently being negotiated. If finalised the partnership would see the two companies going to market with a combined software offering significantly expanding ALU's exposure to Dassault's larger enterprise clients.

MARCH 2020

Secondly, ALU management are focused on the long term and are gradually laying the foundations to bring PCB designers, manufacturers and component suppliers together to “transform the electronics industry” beyond their 2025 subscriber targets. This is enabled by the company’s recently launched cloud collaboration tool (Altium 365) combined with ALU’s online component database (Octopart). These tools have the potential to deliver significant efficiency gains across the industry by increasing collaboration and reducing development cycles.

ALU is led by a strong management team with deep industry expertise and a passion for electronic design. We are confident they possess the skill set and drive to execute on accretive value opportunities going forward. CEO Aram Mirkazemi originally started with the company in 1992 before becoming CEO in 2014 and we are pleased he still retains “skin in the game” with a 7% stake.

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