FUNDS MANAGEMENT

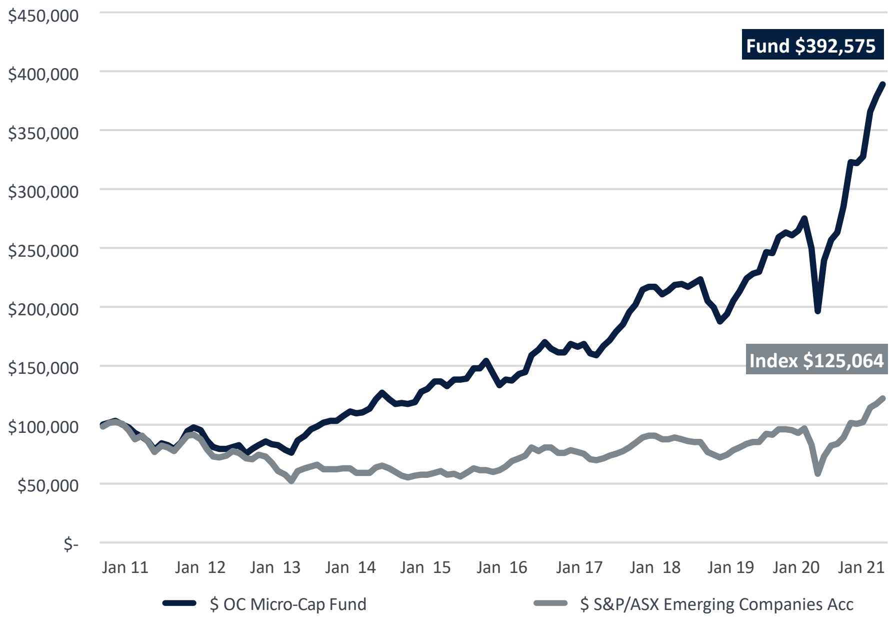
OC Micro-Cap Fund
Fund Update | 31 January 2021

2.7% Fund up 2.7% for the month

22.3% Returned 22.3% p.a. for the past 5 years

We remain confident the Fund is well placed to deliver strong long-term returns

Performance comparison of $100,000 over 10 years*



Total returns

At 31 January 2021†	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Incep. % p.a. (Mar 2003)
OC Micro-Cap	2.7	18.8	41.5	21.5	22.3	21.0	14.7	15.7
S&P/ASX Emerging Comp. Accum	3.9	20.4	27.6	10.7	16.0	10.5	2.3	NA
Outperformance	**-1.3**	**-1.6**	**14.0**	**10.8**	**6.4**	**10.6**	**12.4**	**NA**

Inception date for the Fund is 21/11/2003. Inception date for the Index is 31/12/2003. The performance reflects the performance of the OC Micro-Cap Fund since the change of strategy on 30 September 2016 and the performance of the OC Concentrated Equity Fund prior to that date. Performance is after fees applicable at the time. The total return performance figures quoted are historical, calculated using end-of-month hard-close mid-prices and do not allow for the effects of income tax or inflation.

Performance review

Equity markets continued their strong momentum into the start of the new calendar year with most markets advancing in the early part of the month on the expectation of the vaccine roll-out and the promise of further fiscal and monetary stimulus, particularly in the US. However, early gains reversed as unprecedented retail-led speculative activity in a handful of heavily shorted US companies unnerved investors, stoking fears of asset bubbles which perpetuated a brief sell-off across most equity markets.

The domestic micro-cap index (the S&P/ASX Emerging Companies Accumulation Index) sky-rocketed early in the month and was at one stage up over 11% intra-month, before moderating to finish up +3.9%. The OC Micro-Cap Fund returned a more modest but still credible +2.7% for the month of January.

Perth based property developer **Cedar Woods Properties (CWP, +12.5%)** had a strong month and its share price has now doubled from its COVID-19 induced lows less than 12 months ago where OC initiated a position in the company. The impressive move off its March 2020 share price nadir is illustrative of the opportunities that were on offer last year for shrewd investment managers where some quality companies were being offered at bargain prices. CWP engages in property investment and development in residential, commercial and retail projects across most Australian states (excluding NSW and Tasmania). We have long been impressed with CWP's quality management team and its conservative approach to building its property portfolio and we acquired our position in the company when it had significant valuation support in terms of net tangible asset backing. CWP has traded well over the past 6 months, reporting in a November update that pre-sales were +11% on the prior corresponding period and that the business was well placed to recover from the impacts of COVID-19 with strong earnings growth forecast in FY21. Despite the underlying economic challenges, trading conditions have been supported by fiscal stimulus measures, low levels of new supply, pent up demand in some markets and the ongoing extremely low interest rate environment. We have recently trimmed our holding in CWP, but it remains a key portfolio position and we would expect this to remain the case in the foreseeable future.

January was also another strong month for **Sezzle Inc (SZL, +30.6%)** with investors globally embracing the buy-now-pay-later (BNPL) sector on the back of the stellar US listing of competitor Affirm. The +98% day one rise in the Affirm share price made the other listed BNPL providers look cheap in comparison, despite the strong share price run many of these peers had already experienced in 2020. Beyond the relative valuation argument, however, SZL's core US business continues to grow strongly with the December quarter showing growth in underlying merchant sales of +205%. We expect that the US growth rate will continue to be strong, potentially outpacing larger rival Afterpay over 2021 as the adoption of retail credit provision increases in the US (as has done in Australia). In addition, SZL have launched pilots for potential operations in India and Germany, both of which have the potential to become significant markets in their own right. We continue to own our stake in the business and look forward to catching up with management for their result roadshow in February.

Silk Laser Australia (SLA, +11.8%) was added to the portfolio in mid-December when the company listed on the ASX and was a strong contributor to Fund performance in January. Founded in 2009 by current CEO Martin Perelman, SLA has grown into leading beauty and cosmetic clinic chain with a national network of 56 clinics and ample expansion opportunities. SLA offers five core products and services: Laser Hair Removal, Skincare Treatment, Cosmetic Injectables, Skincare Products and Body Contouring. It has strong industry tailwinds, particularly in the injectables space (anti-wrinkle injections, derma fillers, lip fillers) which is growing at 25% per annum, and underpinned by the increasing desire for consumers to retain a youthful appearance and increased aesthetic awareness overall. SLA has a variety of ownership models including corporate (outright) ownership, joint venture and traditional franchisees, which helps the group exploit different locations and clinic sizes. SLA has a clearly articulated growth strategy that involves: a) organic growth driven by increasing customer penetration and cross-sell opportunities; b) new clinic roll-outs which have strong unit economics supported by procurement benefits and lower medical oversight burden from enlarged network effect and; c) clinical acquisitions, a proven growth driver for the group when entering new geographic locations. Whilst the IPO facilitated a partial private equity sell-down, key management retain a material stake and are highly energised to grow shareholder value.

Panel repair aggregator **AMA Group (AMA, -19.4%)** fell sharply late in the month following the release of a somewhat cryptic announcement by the board in relation to its CEO and Executive Director, Mr Andrew Hopkins. According to the release, Mr Hopkins made an urgent application to the Federal Court of Australia alleging that he was being oppressed as a minority shareholder. A hearing had been scheduled and the company was defending the legal proceedings. In September 2020, the Board had received a protected disclosure from an individual employed by the company and had recently completed an independent investigation in relation to this matter.

The company has been plagued by governance issues in recent years, including issues with former CEO Ray Malone and a related party transaction involving a current non-executive director Simon Moore, so the share price reaction was not surprising in some respects. However, the issues were non-material from a financial perspective and the company reiterated that the business was rebounding strongly from the COVID-19 related slowdown. The Fund increased its holding as the share price fall looked overdone and the stock has subsequently recovered +10% in February on news that Mr Hopkins had resigned from his executive role and his directorship. His replacement is Carl Bizon, a non-executive director with strong manufacturing and leadership experience, whose prior experience includes roles as Managing Director at Horizon Global, Jayco Corporation (Australia) and Swan Plumbing Supplies. We have been in regular touch with the AMA Chairman Anthony Day and have scheduled a meeting with the incoming CEO in the coming weeks.

Australia and NZ based consumer lender **Harmoney Corp Limited (HMY,-17.0%)** was down for the month, despite a positive update for 1H21 loan originations which exceeded prospectus forecasts. HMY is a leading digital personal lender in the Australian and NZ consumer credit markets and listed on the ASX in November 2020. HMY employs innovative internet-based marketing strategies to originate loans online directly, which generates higher repeat customers than the industry average. HMY is experiencing a return to pre-pandemic lending volumes with 47% growth in quarterly originations, after a period of lower originations due to a prudent restriction in credit approvals. The expansion in originations is expected to continue into the 2H21 given the favourable macro back drop in both Australia and NZ. The positive macro environment is also reflected in strong credit performance with +61 day arrears down to 1.3% in December from 1.6% as at June. HMY is also transitioning from a peer-to-peer lender to a lower cost warehouse funded model, with a third warehouse funding facility with capacity for NZ$200m established before Christmas 2020. Warehouse funding constitutes 42% of HMY's loan book, with the majority of the book likely to be fully warehouse funded during FY22. Despite the disappointing share price performance since listing, we see HMY as well positioned to capitalise on the ongoing structural shift towards non-bank lenders with a favourable macro environment.

Outlook

Markets have resumed their upward trajectory having briefly been unnerved toward the end of January by the speculative frenzy in the shares of video game retailer GameStop and a few other heavily short sold stocks in the US, which was incited by retail investors collaborating on social media platform Reddit. Whilst these stocks are now plummeting back to earth, it is a timely reminder that we are in a time of heightened risk with ultra-easy monetary policy, massive central bank-led bond purchases and fiscal stimulus geared towards supporting the economic recovery likely to lead to ongoing asset price volatility. It is a time when investors ought to remain vigilant given that policy conditions have never been more accommodative, albeit concerns about equity or property market bubbles were recently brushed aside by Reserve Bank Governor Philip Lowe.

Whilst US GDP growth expanded at an estimated 4% annual rate in the fourth quarter (according to the Bureau of Economic Analysis), employment and retail sales both fell in December. The market, however, continued to brush aside negative data and continued to focus on the positive news out of the US government and the US Federal Reserve who reiterated their commitment to the COVID-19 recovery effort. The House of Representatives has recently approved President Biden's $US1.9 trillion stimulus plan, advancing it despite unanimous Republican opposition as Democrats pressed to speed it through the House by the end of the month. Late in the month the US Federal Reserve reiterated its ongoing commitment to zero rates saying it would keep buying at least $US120 billion of bonds a month and would maintain this approach until its goals of lower unemployment and 3% inflation are achieved.

In Australia, the RBA maintained the cash rate at 0.1 per cent, extended its bond buying program by another $100b and anchored its overnight cash rate to this record low level until at least 2024. The ongoing quantitative easing by the RBA is a necessary response to aggressive central bank measures overseas to keep yields low so that our currency remains in check and exports remain competitive as it pursues its goal of full employment and economic recovery. During the month RBA Governor Dr Philip Lowe conceded that the economic recovery had surprised on the upside and GDP was now expected to return to its pre-pandemic levels by the middle of the year. But the RBA seems determined to achieve its longer-term policy objectives and has played down concerns about asset price bubbles and emerging inflationary forces as it steers a course of full economic recovery from the COVID-19 pandemic.

It is little surprise, given the prevailing macro-economic backdrop, that cyclical stocks are enjoying a resurgence in markets. More specifically, the so called 'reflation trade' has been growing in prominence with stocks exposed to the prospect of a return to sustained economic growth, price pressure and higher yields particularly strong in recent weeks. Arguably the policy settings of central banks and governments bode well for small-cap stocks and cyclical sectors such as financials, building materials and commodity producers which ought to perform well if these reflationary forces gather momentum.

Summer holidays are now a distant memory and the IPO pipeline is once again burgeoning with the investment team meeting one-on-one with Grays Online, Aurora Healthcare, Airtasker, Newmark Property Group and My Food Bag to mention just a few prospective float candidates in recent weeks. As with the August reporting season, many of our Fund holdings have either pre-reported results or provided a decent level of transparency to the markets in the lead up to first half results. What remains unclear is how companies will guide the market going forward, especially given that much of the direct government stimulus to businesses and consumers has either ended or been wound back, although monetary and fiscal policy overall remains supportive of an ongoing economic recovery.

The OC investment team has a full schedule for the upcoming month, with the bulk of our meetings taking place digitally due to the ongoing health concerns about face-to-face meetings and interstate travel. The COVID-19 vaccine rollout globally is gathering momentum and is due to kick-off in Australia this month. Unfortunately, we are not out of the woods yet from a health perspective with mutant COVID-19 strains emerging, which could potentially be resistant to existing vaccines, and new clusters of infection appearing periodically. It is a constant reminder that ongoing vigilance is required from everyone and that the road to normalcy for us all is still a way off.

Top 5 holdings#

Company	ASX code
Booktopia Group	BKG
Frontier Digital Ltd	FDV
MNF Group Ltd	MNF
Propel Funeral	PFP
Telix Pharmaceutical	TLX

The top 5 portfolio holdings are in alphabetical order and may not be representative of current or future investments.

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[†]The total return performance figures quoted are historical, calculated using hard-close end-of-month mid-prices and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. The performance is quoted net of all fees and expenses. The index does not incur these costs. This information is provided for general comparative purposes.
[*] The performance comparison of $100,000 over 10 years is for illustrative purposes only. All returns shown are based on Australian dollar figures. Past performance is not a reliable indicator of future performance. The total returns shown are prepared on an ongoing basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the S&P/ASX Emerging Companies Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.