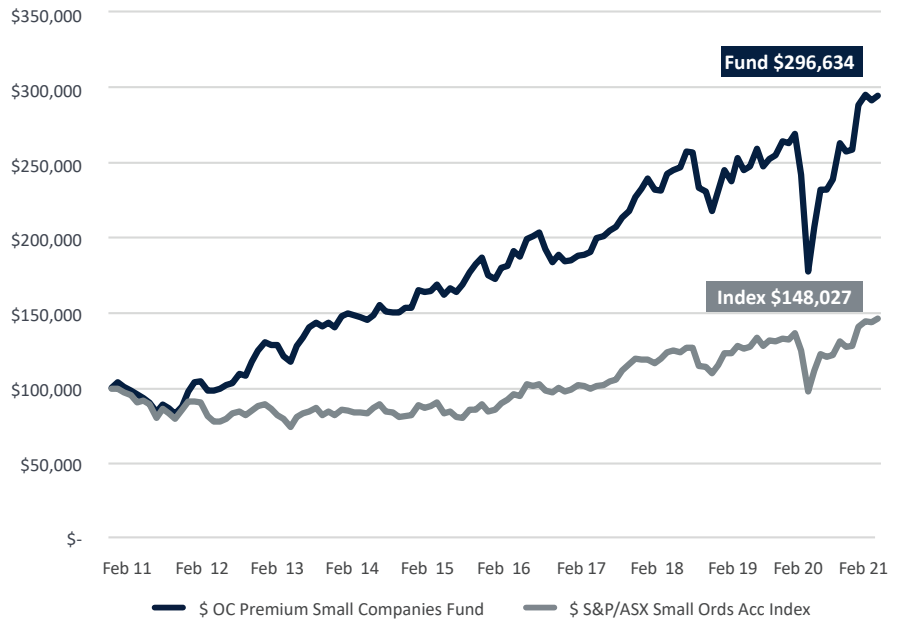


**1.1%** Fund up 1.1% for the month

**11.5%** Returned 11.5% p.a. for the past 10 years

We remain confident the Fund will continue to deliver attractive long-term returns

Performance comparison of \$100,000 over 10 years\*



Total returns

At 28 February 2021 <sup>†</sup>	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. (Dec 2000)
OC Premium	1.1	2.1	21.8	7.2	11.4	10.4	11.5	11.2
S&P/ASX Small Ords Accum	1.5	4.1	17.2	7.2	11.7	8.1	4.0	6.3
<b>Outperformance</b>	<b>-0.5</b>	<b>-1.9</b>	<b>4.6</b>	<b>-0.1</b>	<b>-0.3</b>	<b>2.3</b>	<b>7.5</b>	<b>4.9</b>
S&P/ASX Small Ind Accum	1.4	2.9	12.9	8.0	10.5	8.7	8.7	6.7
<b>Outperformance</b>	<b>-0.4</b>	<b>-0.7</b>	<b>8.9</b>	<b>-0.8</b>	<b>0.8</b>	<b>1.7</b>	<b>2.9</b>	<b>4.5</b>

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

The OC Premium Small Companies Fund enjoyed a solid reporting season finishing the month up +1.1%. The Fund performance was slightly behind the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which were up +1.5% and +1.4% respectively for the month. It is now just on a year since the COVID-19 pandemic spread to our shores causing significant collateral damage in the domestic equity market. Over that period, the OC Premium Small Companies Fund has returned investors +21.8% which is well ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which are up +17.2% and +12.9%, respectively, over the same time horizon.

Tourism and transport business **Sealink Travel Group (SLK, +32.6%)** reported a strong interim result which reinforced the resilience of its business model given the significant operational challenges it overcame during the period operating a business exposed to COVID-19 induced tourism and social distancing restrictions. During

HY21, the Transit Systems (TS) bus division reported a solid result as well as winning and renewing key contracts including in Singapore, Adelaide, Perth and the Northern Territory. The Marine and Tourism (M&T) division surprised on the upside with EBITDA of \$34.7m, which is back to pre-COVID-19 levels despite revenue not yet fully recovering. A focus on tight cost control and extracting operational efficiencies in the challenging COVID-19 environment saw the M&T division significantly improve its operating margins. The SLK business is very well positioned going forward with TS well positioned for success on material upcoming tenders, particularly in Melbourne and Sydney, and the M&T division is expected to benefit as domestic travel opens up in the coming months once the vaccine roll out gathers momentum. Around 83% of SLK’s revenues are now contracted, with governments being the main counter parties. We expect the stock will continue to re-rate in the coming months on further contract wins and as the market gains a greater appreciation of the high quality nature of the company’s earnings stream.

Telecommunications infrastructure owner and service provider **Vocus Group (VOC, +22.3%)** received a takeover approach early in the month which sent the share price sharply higher. The proposal, originally from Macquarie's MIRA, was joined later in the month by industry fund Aware Super. The company also reported a solid half year result, including slightly higher guidance for the core Vocus Network Services business unit, and mapped out five potential major network expansion projects to undertake to utilise the funds to be raised by the IPO of its New Zealand subsidiary. These plans now seem unlikely to come to fruition in public hands with the takeover scheme being formalised early in March at a price of \$5.50 per share with expected completion in July 2021.

In the January Monthly Review, we mentioned two stocks falling under the broader 'reflation trade' theme that have recently been added to the portfolio, namely **Liberty Financial Group (LFG, +10.5%)** and **Virgin Money UK Plc (+39.5%)**. Both companies were strong performers in February and ought to continue to be beneficiaries of a recovery in global growth, an increase in price pressures and higher yields. The Fund increased its holdings in both stocks early in February.

LFG produced an outstanding first result as a listed business during the month and upgraded its FY21 prospectus forecast by more than 20%. The strength in the result and outlook were driven by the 'positive jaws' of higher net revenue growth than cash expense growth, lower overall funding costs leading to a better net interest margin (NIM) than originally forecast and lower bad and doubtful debts. We believe that LFG remains well positioned to exceed its revised profit forecasts in the full year and its balance sheet looks conservatively provisioned given the improving economic outlook and strengthening housing and employment markets.

VUK reported a solid second quarter earnings update early in February and with Brexit negotiations now finalised and the UK starting to emerge from a deep COVID-19 induced malaise, it looks like an attractive macro-economic recovery play. Going forward, VUK is well positioned with greater near-term certainty around capital and credit risk, potential upside to its NIM, and a cost out story that is still playing out from the integration of the Clydesdale and Virgin Money businesses. VUK still looks fundamentally cheap despite the recent share price rise, trading on a Price/Book ratio of around 0.6x and a FY22 PE of 9.6x consensus earnings.

The Fund also added **Bank of Queensland (BOQ, +13.6%)** to the portfolio during the month after we participated in the group's capital raising and sub-underwriting to fund the purchase of Members Equity Bank Limited (ME Bank) for \$1.35b. Like LFG and VUK above, BOQ is well

positioned to benefit from a reflationary environment and the trading update it announced concurrently with the acquisition showed early signs of this with credit quality, NIM and loan impairments expense all exceeding consensus expectations leading to earnings upgrades for FY21 and beyond.

The ME bank deal makes strategic sense for BOQ on several fronts increasing the scale of its mortgage book by 57% and arguably improving its risk profile by diversifying the business away from Queensland and increasing the skew towards home lending. The target of \$70-80m in cost synergies (22-25% of ME Bank's cost base) looks conservative compared to previous regional bank mergers at approximately 30%, although BOQ will maintain a multi-brand strategy (Bank of Queensland, Virgin Money and ME Bank) whilst using common products and platforms. Given BOQ's higher credit rating and improved funding mix we expect that management may also be able to achieve a higher NIM by improving the cost of ME Bank's deposit offering and wholesale funding program. The Fund received a small allocation in the institutional offering and we also purchased stock on market during the month at a price below the month end closing price.

With bond yields, particularly the US 10-year treasury yield, moving steeply higher during the month the technology sector came under considerable pressure late in February and some of the Funds key tech exposures finished the month sharply lower including **Redbubble Limited (RBL, -23.7%)**, **Kogan Limited (KGN, -22.3%)** and recent **IPO Nuix Limited (NXL, -33.9%)**. Several clients have asked us why technology shares are so sensitive to movements in treasury yields and the answer, simply put, largely revolves around the opportunity cost of capital. The US 10-year treasury is typically used as a proxy for the 'risk free rate' when calculating the cost of capital. Therefore, when bond yields rise then so too does the cost of capital meaning that any cashflows received in future periods and discounted back to today's value are worth less. Long duration growth assets like technology shares often have relatively low cashflow today but are growing rapidly into the future. Therefore, when the cost of capital increases, these future cashflows are worth less in today's dollar terms after they are discounted back. As a result of this dynamic, the valuations on high growth stocks like technology and healthcare shares often fall disproportionately when 10-year treasury yields rise. The Fund has reduced its exposure to the technology sector since the start of the calendar year.

The share price fall of high growth tech IPO Nuix (NXL) during the month was exacerbated after its first half result underwhelmed investors just months after joining the ASX bourse. NXL is a global company that provides investigative software which enables indexing, searching, analysing, and extracting knowledge from unstructured data sets

and documents. Its key client's include governments, law enforcement agencies, professional services firms and large corporates. NXL's first half revenue growth was behind the market expectations with management calling out a slippage in US government contracts due to the federal election as the culprit. The company did reiterate its full year earnings guidance and expressed confidence that the US government spend would likely be captured later in the year, due to the strength of its government relationships. As a high multiple growth stock, there was no doubt the market was looking for validation in the result that the prospectus forecasts could be exceeded. Notwithstanding this blemish, the broader long-term investment thesis for NXL appears to be intact and the quantum of the sell-off therefore seems overdone.

**NRW Holdings (NWH, -29.7%)** was sold aggressively by the market on release of a disappointing half year earnings report and outlook. In the lead up to the release of the result, investors had been focussed on key positive tail winds that were expected to provide a boost to NWH, including its accretive acquisition of Primero Group (PGX), the ongoing strength of the iron ore price (which is supportive of its customers' capex intentions) and the bullish state of east coast housing market where NWH has a meaningful presence in civil construction through Goldings. The acquisition of PGX was a particular focus for investors with the PGX engineering capability and exposure to the booming Lithium sector expected to round out NWH's full service offering to its extensive resources client base. However, the market was surprised by the magnitude of the COVID-19 impacts on its mining and civil divisions, particularly in the Pilbara, where the company was forced to manage new government imposed regulations which drove higher staff turnover and a less flexible labour pool. This forced NWH to engage a less experienced workforce which in turn contributed to lower margins earned across these key divisions. Whilst NWH revealed a record order book at the result, investors were disenchanted with the poor communication by management of the COVID-19 impacts and sold the stock aggressively post the result. OC has exited its position but will continue to consider NWH as an investment as we get more comfort around NWH's management of the COVID-19 impacts on its workforce and its ability to restore earnings margins.

## Outlook

The February reporting season was one of the strongest in recent years, despite the significant COVID-19 disruptions with positive earnings surprises outweighing earnings disappointments across the broader Australian market, including the domestic small cap space. The positive upside in company results was largely driven by upside surprise on operating margins, rather than top line

revenue growth and consensus earnings forecasts across the market have moved higher for the balance of the financial year. But the strength of the results period has been largely overshadowed by a surge in treasury yields with both the Australian 10-year treasury (month end 1.76%) and the US 10-year treasury (month end 1.44%) moving sharply higher and spooking markets that have become accustomed to the 'lower for longer' rhetoric on interest rates from our central bankers.

Rising treasury yields seem to be signalling that inflationary pressures are building and that interest rates may have to rise sooner than our central bankers would have us believe. The global economy seems now to be on a sustained pathway to recovery and the global rollout of COVID-19 vaccines has fuelled a wave of optimism in the global economy at a time when the market is awash with liquidity provided by record low interest rates and central bank quantitative easing, along with government stimulus programs. All this has the potential to see inflationary pressure build ahead of plan and this is what has created ructions in global bond markets in recent weeks. Given that lower bond yields have been a key driver of multiple expansion across equity markets in recent years, investors have been unnerved.

The pivotal question is whether we are witnessing the beginning of an inflationary wave which could force the hand of policy makers and necessitate interest rates rising at a time when the global economy is still relatively early in its recovery phase. This would have strong negative implications for equity markets. Or are our central bankers, including the US Federal Reserve and the RBA, indeed correct in that any near-term price rises will prove to be transitory in nature given that the labour market remains significantly under-utilised and the risk of sustained inflation is therefore still very low.

At this juncture, we are not convinced that sustained inflation is in our immediate future and feel it is most unlikely that central banks will need to abruptly pivot any time soon and embark on a round of interest rate rises. Rather, we view rising treasury yields as the natural consequence of a reflationary environment and that some price rises are a natural and healthy part of the economic recovery. We expect that treasury yields will likely continue to rise in the near-term but remind our investors that even with the recent increases in bond yields, the long-term yields remain at historically very low levels.

We have nevertheless rotated our portfolio somewhat in recent weeks reducing our weighting towards the technology sector and increasing our exposure to sectors such as financials and cyclical areas of the economy that are levered toward an ongoing recovery. Should

evidence of inflationary forces become more pervasive in the coming weeks or months this would necessitate us rotating further away from long duration growth assets such as technology and healthcare towards cyclical, commodity and financial stocks that will likely perform better in such an environment.

### Top 5 holdings<sup>#</sup>

Company	ASX code
Bapcor Limited	BAP
Eagers Automotive	APE
Mineral Resources	MIN
Sealink Travel Group	SLK
Steadfast Group Ltd	SDF

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

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<sup>†</sup>The total return performance figures quoted are historical, calculated using cum-distribution end-of-month hard-close 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.

<sup>\*</sup>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 Small Ordinaries 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.

Past performance is not a reliable indicator of future performance. Positive returns, which the OC Premium Small Companies Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. A performance fee of 20.5% is payable annually on any excess performance (after deducting the management fee) above the benchmark, S&P/ASX Small Ordinaries Accumulation Index, to 30 June. A performance fee is only payable where the Fund has returned 5% or more since the last performance fee was paid. This document is for general information purposes only and does not take into account the specific investment objectives, financial situation or particular needs of any specific reader. As such, before acting on any information contained in this article, readers should consider the appropriateness of the information to their needs. This may involve seeking advice from a qualified financial adviser. Copia Investment Partners Ltd (AFSL 229316, ABN 22 092 872 056) (Copia) is the issuer of the OC Premium Small Companies Fund (ARSN 098 644 976). A current PDS is available from Copia located at Level 25, 360 Collins Street, Melbourne Vic 3000, by visiting [ocfunds.copiapartners.com.au](http://ocfunds.copiapartners.com.au) or by calling 1800 442 129 (free call). A person should consider the PDS before deciding whether to acquire or continue to hold an interest in the Fund. Any opinions or recommendation contained in this document are subject to change without notice and Copia is under no obligation to update or keep any information contained in this document current.