OC FUNDS MANAGEMENT

OC Micro-Cap Fund

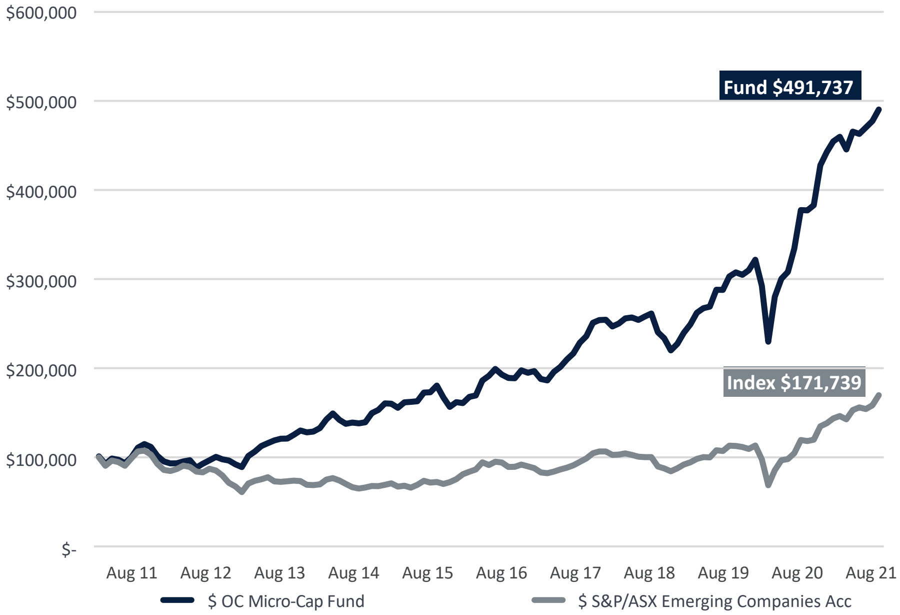
Fund Update | 31 August 2021

2.7% Fund up 2.7% for the month

20.8% Returned 20.8% 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 August 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	5.9	30.0	24.0	20.8	18.7	17.3	15.7
S&P/ASX Emerging Comp. Accum	7.3	8.9	43.3	19.7	13.5	12.4	5.6	NA
Outperformance	**-4.6**	**-3.0**	**-13.3**	**4.3**	**7.3**	**6.3**	**11.7**	**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

The August reporting season brought a continuation of the positive momentum in equities with the domestic small-cap market shrugging off the impacts of the COVID-19 Delta variant and protracted lockdowns in both NSW and Victoria, as well as news that both the Reserve Bank of Australia and US Federal Reserve will likely begin to taper bond purchases later in the year, to surge to fresh highs. The markets looked through the COVID-19 restrictions and instead focussed on a likely reopening of the economy in the coming months as vaccination levels surge with so called ‘re-opening’ trades exposed to global growth amongst the best performers for the month of August.

The OC Micro-Cap Fund returned +2.7% in August, which lagged the S&P/ASX Emerging Companies Accumulation Index, which was again very strong, up 7.3% for the month. It is certainly a ‘risk-on’ environment with some of the more speculative companies in the index including early-stage lithium, uranium and biotechnology stocks performing vey strongly. Long-term investors will know that OC Fund’s is relatively risk adverse and we find this this part of the market opaque and therefore difficult to value and typically avoid it, other than for short term event driven trades. When the ‘heat’ comes out of the market, or there is a material pull-back, these speculative stocks tend to fall disproportionately. In the near-term however, we have no doubt underperformed the index albeit we continue to produce our investors strong long-term returns.

Readytech Holdings (RDY, +40.3%) was up for the month after reporting a solid result for FY21 combined with robust guidance for FY22. RDY reported 15% organic revenue growth in FY21 driven by new business wins across all key divisions. RDY also unveiled a medium-term revenue target of $125M by FY26 based on organic revenue growth. RDY is a provider of mission-critical software as a service (SaaS) for the education, workforce management, government and justice sectors. The Fund acquired its holding in RDY at a capital raise in November 2020 when the company acquired government and justice software provider Open Office from Pemba Capital. We had followed RDY since it was listed by former private equity owner Pemba Capital via an IPO in 2019. RDY has largely executed to plan yet has traded below peer valuations due to the history of private equity ownership, perceived stock overhang and the stigma attached to the Open Office acquisition (which was a portfolio company of Pemba Capital which still holds a material interest in RDY). Our thesis has been that the stock should re-rate if management can deliver clean results and organic growth and we are pleased to report that we are beginning to see this play out.

Hipages Group (HPG, +13.8%) rallied during the month after delivering a maiden listed result in line with company guidance that had been upgraded from prospectus at its third quarter update in late April 2021. Whilst social distancing restrictions will have a short-term impact on the ability of HPG's customers to generate revenue, the Australian home improvement market is likely to remain robust over the medium term. HPG is Australia's largest online tradie (plumbers, electricians, carpenters etc.) marketplace which connects tradie customers with residential and commercial consumers. The HPG platform helps tradies grow their business by providing job leads from homeowners and organisations looking for qualified professionals. HPG has a subscription revenue model which charges tradies a monthly subscription in return for credits with which to purchase customer leads. HPG continues to transition its tradie customers to subscription packages which should be complete in FY22. HPG is targeting higher spending tradies (who exhibit lower churn) and attempting to upgrade the existing tradie customer base. This improving customer base will drive improved revenue quality and will also provide support for continued ARPU growth. HPG is also likely to expand into new job channels and offer ancillary product opportunities to tradies, such as payments, finance and insurance.

Lotus Resources (LOT, +14.7%) performed strongly during the month, in line with most Uranium exposed stocks, as equity investors detected the first glimpses of life in the Uranium spot price market which has been virtually dormant for many years. LOT owns the mothballed Kayelekera Uranium mine in Malawi which it is currently working toward bringing back into production. The mine is one of the few in the world that has previously produced commercial quantities of product, and which is also capable of being brought back online at a relatively low overall recommissioning cost. A higher spot Uranium price is the final piece of the puzzle that Lotus requires in order to return the Kayelekera mine to profitable operation in the short to medium term. A key driver of the apparent bottoming out of the Uranium spot price (from the stagnant levels of around US$30/pound) has been much anticipated launch of the Sprott Physical Uranium Trust (SPUT) by North America based global commodities powerhouse, Sprott Asset Management. In the last few weeks SPUT has been deploying its substantial capital firepower into the acquisition of physical uranium in the spot market and this has had the effect of driving the spot price higher. Coupled with Uranium's ability to contribute to a net zero carbon economy, which is becoming a global imperative, we expect the Uranium market, and LOT, to continue to outperform in the short to medium term.

Shares of **Imricor Medical Systems (IMR, -32.0%)**, the developer of equipment and consumables for carrying out MRI-guided cardiac catheter ablation procedures, retraced significantly in August. Whilst the company is on track in many regards with its pre-IPO objectives, the all-important measure of revenue is lagging as a result of COVID-19 induced slow down on new centre signings and the deferral of non-urgent hospital procedures which saw existing clients reduce their throughput. While the market is often prepared to look through the near-term impacts of COVID-19 on businesses, in this case it was clear that the company was going to need to raise additional capital due to the delayed revenues. With potential buyers of the stock holding off and waiting for a chance to participate in a discounted placement, and the absence of any significant announcements to drive the share price higher, the stock price ground lower on low volumes until finally, in early September, the company launched the capital raising that the market had been waiting for. The raising was done at minimal discount to the then trading price and subsequently we have seen the stock price begin to recover. The company has a strong pipeline of sales opportunities and with the easing of COVID-19 restrictions in Europe (the company's primary sales market at present), IMR expects to be in a position to announce sales agreements with new (and resumed) clinics and hospitals.

Spirit Technology Solutions (ST1, -16.1%) finished lower for the month after it delivered a cautious outlook that tempered investor enthusiasm around what was an otherwise solid FY21 result for the business. With a market capitalisation of just under $200m, ST1 is an acquisitive IT and telco service provider with a core focus on its existing SME's customer base. It is also ambitiously moving toward building out its mid-market and enterprise-government presence. As ST1 has grown its product offering, it is now well positioned to pursue these larger customers which typically require more services, sign larger and longer contracts, and accordingly deliver greater revenue certainty for ST1. Whilst it delivered a FY21 result in-line with market expectations, ST1 is currently being impacted by COVID-19 workforce restrictions and lockdowns in its core operating geographies of Melbourne and Sydney and hence there is a degree of uncertainty regarding its near-term outlook which has driven some share price weakness. With the country expected to emerge from restrictions toward the end of this calendar year, we believe ST1 will be well positioned to resume its solid trajectory of growth in CY22.

Outlook

The August reporting season was broadly positive in domestic equities with investors looking through lockdowns in NSW and Victoria to instead focus on optimism around the likely reopening of our two largest state economies once vaccine targets are met (expected to be 70% to 80% vaccination rates), which is currently projected to occur in October and November respectively. Earnings per share (EPS) across the ASX 200 grew an impressive +28% in FY21, although an elevated number (~45%) of companies still missed consensus expectations, which is well above historical averages. Few companies were bold enough to offer earnings guidance for FY22 with most pointing to uncertainty around lockdowns and government-imposed restrictions for their reluctance to forecast for the year ahead.

The OC Investment team has met with more than 100 companies over the past month and there are some key themes that consistently emerged from our discussions. These included:

- Supply Chain Issues – delays, shortages and rising costs in the supply chain of companies, predominately caused by COVID-19, were called out by many industrial and mining business and are expected to persist well into the new calendar year.
- Inventory Build – industrial businesses called out inventory shortages brought about by supply chain issues and forward planning retailers have consequently built inventory well ahead of the usual seasonal Christmas peak.
- Labour Shortages – despite millions of workers being sidelined due to COVID-19, labour shortages were widely cited as an issue. This was particularly so in the WA mining and mining services sectors due to border restrictions slashing the pool of skilled labour, and also in industries that are reliant on foreign workers such as horticulture, childcare and panel repair.
- Inflationary Pressures – partially a corollary of the above three issues, inflationary pressures in the form of rising freight costs, raw material inputs, electrical components, food and labour costs were often called out by management.

Whilst the above challenges would ordinarily be taken in a dim light by investors if they were long-term or structural issue, they have largely been brought about by the challenges of operating within the confines of COVID-19 induced restrictions. As such, the market has rightly viewed most of them as being transitory in nature and they ought to begin to unwind once vaccination levels grow and the world gets back to some level of normality. It is less clear whether inflationary pressures will totally subside, but bond markets and policy settings of our central bankers are currently reflecting the view that these pressures too will prove to be largely temporary in nature.

No doubt quantitative easing programs from central banks have been a crucial factor in providing invaluable liquidity to markets and keeping interest rates low at a time of great upheaval in the global economy. Indeed, the US Federal Reserve's willingness to do 'whatever it takes' to support markets through the COVID-19 crisis has been credited with helping to save the global economy from plumbing a very dark abyss. It should therefore be no surprise that the market had become somewhat apprehensive about a potential premature withdrawal of support by the US Federal Reserve ("the Fed") given the ongoing pain inflicted by the COVID-19 Delta variant, notwithstanding the strengthening employment and economic backdrop in the US which has continued to defy the health statistics.

It was therefore a cause of great relief for markets when the Fed Chairman Jerome Powell decoupled the discussion around reducing bond purchases ("tapering") and that of interest rate hikes at the widely anticipated virtual speech that he delivered at the Kansas City Fed's annual Jackson Hole Symposium. The US economy has now made "substantial further progress" toward the Fed's inflation objective that its governors said would be a pre-condition of tapering bond purchases and the labour market had also made "clear progress". Governor Powell has indicated that if "the economy evolved broadly as anticipated", the Fed would likely start tapering bond purchases later this year. But in an important call-out, he said that this move would not necessarily result in higher interest rates in the near term. Markets had been concerned that a sudden withdrawal of liquidity through tapering, when combined with rate hikes, would not only derail the economic recovery and hit company earnings at a time when the COVID-19 Delta variant still loomed large, but could also undermine what has been an important underpinning of asset price expansion in recent years, namely record low interest rates.

Our own RBA Governor Philip Lowe echoed the positive sentiment of the Fed at the RBA board meeting last week whilst also confirming it would taper, reducing the pace of weekly bond purchases from $5b to $4b "until at least February 2022". With June quarter GDP printing at a relatively healthy +0.7% earlier in September, it now seems likely that Australia will be spared a double dip recession reinforcing the incredible resilience of our domestic economy. Whilst GDP is expected to materially decline in the September quarter (economists predict the economy could contract up to 4%) and the unemployment rate is forecast to track higher in the coming months, the latest downturn is expected to be only temporary. As vaccination rates increase towards key state set thresholds (70-80%) and restrictions are eased, the Australian economy is once again expected to bounce back with the RBA expecting that the economy will "again be growing in the December quarter".

Whilst the pathway out of COVID-19 Delta variant lockdowns and health consequences of an economic reopening when infection rates are still high are still somewhat unclear, the domestic economy is likely to enter the new calendar year with renewed momentum. The RBA has reaffirmed its important commitment to maintain interest rates at its 0.1% target to 2024, in effect extending the accommodative financial conditions that have been so supportive of equity markets since April 2020. Whilst there are some notable challenges for listed companies, including those talked about earlier in the outlook, we remain upbeat overall about the prospects of companies in our portfolio and have recently increased our exposure to some more cyclical businesses.

Post our reporting season management catch ups, we have an extensive company visitation program planned in the coming weeks to catch up with companies who have piqued our interest over the last few weeks. The corporate pipeline is again building, and we are already in early-stage due diligence on several IPO candidates that may list in the back end of CY21. We thank our investors for their ongoing support and remain committed to our goal of generating strong long-term risk-adjusted returns for our clients.

Top 5 holdings#

Company	ASX code
Adairs Limited	ADH
Booktopia Group	BKG
Monash IVF Group Ltd	MVF
Telix Pharmaceutical	TLX
Viva Leisure Limited	VVA

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

CONTACT COPIA

1800 442 129 | clientservices@copiapartners.com.au | copiapartners.com.au

John Clothier	General Manager, Distribution	0408 488 549 | jclothier@copiapartners.com.au
Iain Mason	Director, Institutional Business	0412 137 424 | imason@copiapartners.com.au
Mani Papakonstantinos	Distribution Manager	0439 207 869 | epapakonstantinos@copiapartners.com.au
Jude Fernandez	Distribution Manager	0414 604 772 | jfernandez@copiapartners.com.au
Sam Harris	Distribution Manager	0429 982 159 | sharris@copiapartners.com.au

[†] 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.

Past performance is not a reliable indicator of future performance. Positive returns, which the OC Micro-Cap Fund (the Fund) is designed to provide, are different regarding risk and investment profile to index returns. A performance fee of 20.5% is accrued daily on any excess performance (after deducting the management fee) above the performance benchmark within a performance period. Any accrued performance fee will become payable if the Fund's return is positive at the end of the performance period. If the Fund's return is negative, any performance fee accrual will continue to be carried forward. The performance benchmark is the return of the S&P/ASX Emerging Companies Accumulation Index. The inception date of the S&P/ASX Emerging Companies Accumulation Index is 31 December 2003. 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 suitability of the information for 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 Micro-Cap Fund (ARSN 126 537 424). A current PDS is available from Copia located at Level 25, 360 Collins Street, Melbourne Vic 3000, by visiting ocfunds.com.au, by calling 1800 442 129 (free call) or by emailing clientservices@copiapartners.com.au. A person should consider the PDS before deciding whether to acquire or continue to hold an interest in the Fund. Any opinions contained in this document are based on information available to Copia at the time and may be subject to change without notice. Copia is under no obligation to update or keep any information contained in this document current.