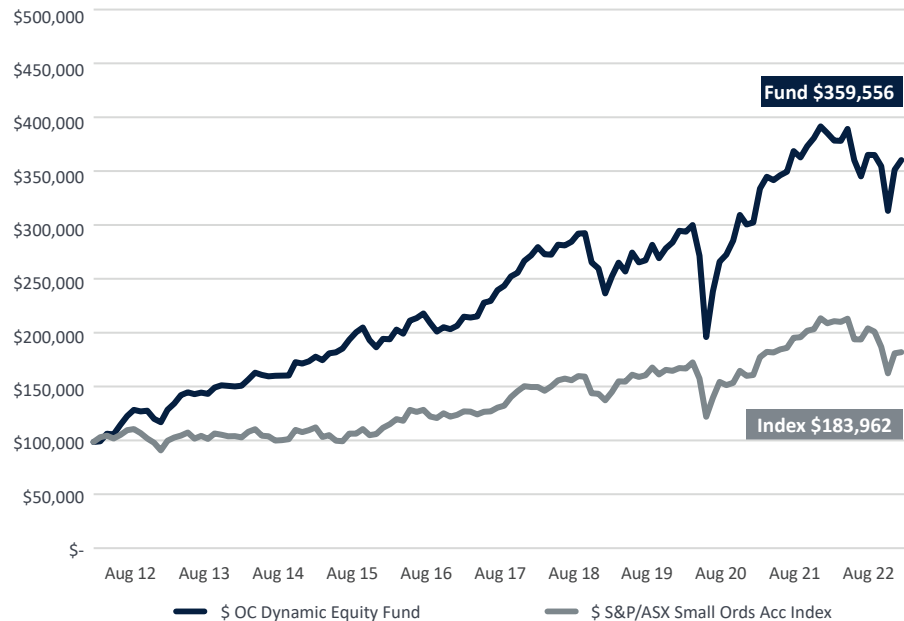


**2.6%**  
Fund up 2.6% for the month

**13.7%**  
Returned 13.7% 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 31 Aug 2022 <sup>1</sup>	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.	Incep. % p.a. (Dec 2000)
OC Dynamic	2.6	1.6	-8.0	10.1	8.5	13.7	12.0
S&P/ASX Small Ords Accum	0.6	-2.6	-14.7	4.1	6.9	6.3	5.9
<b>Outperformance</b>	<b>2.0</b>	<b>4.2</b>	<b>6.7</b>	<b>6.0</b>	<b>1.6</b>	<b>7.4</b>	<b>6.0</b>
S&P/ASX Small Ind Accum	-1.0	-0.5	-20.0	1.0	5.1	7.9	5.9
<b>Outperformance</b>	<b>3.6</b>	<b>2.1</b>	<b>12.1</b>	<b>9.2</b>	<b>3.3</b>	<b>5.8</b>	<b>6.0</b>

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.

### Performance review

The OC Dynamic Equity Fund returned +2.6% in August on the back of a solid reporting season for most of our portfolio holdings, continuing the positive momentum we saw in the July rebound. This was ahead of both the S&P/ASX Small Ordinaries Accumulation Index and the S&P/ASX Small Industrials Accumulation Index which were up +0.6% and down -1.0% respectively for the month. Whilst the trajectory of consensus earnings revisions was generally negative across the Australian small-cap market in August, we were pleased with the results of the Fund's holdings overall and remain optimistic about their prospects for the year ahead, notwithstanding the current macro-economic and geopolitical challenges.

**Nitro Software Limited (NTO +37.4%)** rallied strongly in August after disclosing a non-binding indicative proposal from a private equity consortium comprised of Potentia Capital and HarbourVest Partners to acquire all the issued capital of NTO for \$1.58 cash per share. The proposal is conditional on six weeks of due diligence, exclusivity provisions and board approval. Whilst the proposal

is opportunistic, Nitro reduced its guidance for CY22 Annualised Recurring Revenue (ARR) by 12% in July and requires a solid operating outcome in the second half to hit its revised guidance. NTO was a relatively small position in the Fund and we elected to sell into the private equity consortium when approached in a pre-bid raid on the NTO register at the indicative bid price. OC Funds took the view that the certainty of a 40% cash premium in the short term is likely to provide a better outcome on a risk versus return basis than banking on future ARR growth and a potential re-rate in the revenue multiple in an environment where the US Federal Reserve is hiking interest rates and may yet raise rates further than the market expects. NTO is still burning cash and any further slippage in management's forecasts is likely to be harshly treated by the market as it would result in the requirement for further equity funding before cash-flow breakeven is reached by the company. In terms of the indicative bid, the NTO board is intent on holding out for a better offer which may or may not emerge given that the current consortium holds a substantial 19.9% blocking stake.

**NRW Holdings (NWH, +26.0%)** share price responded positively during the month as investors were buoyed by a strong set of numbers reported at its FY22 result which also outlined a bright outlook for the business. The annual result was particularly impressive as it was delivered against the backdrop of significant COVID-19 related workforce pressures in NWH's core WA market. NWH is a leading provider of diversified contract services to the resources and infrastructure sectors. With a 6,000 strong employee base, NWH's core Civil & Mining divisions provide civil construction services, including bulk earthworks, road and rail construction and concrete installation, together with contract mining and drill and blast services. In recent years, NRW has built out more resilient business capabilities by forming a Minerals, Energy & Technologies (MET) division through the acquisition of RCR Mining Technologies, DIAB Engineering and Primero Group which together should deliver more stable earnings offsetting the highly cyclical coal/iron ore exposures that the core business can be exposed to. The MET division offers tailored mine to market solutions, specialist maintenance (shutdown services and onsite maintenance), non-process infrastructure, innovative materials handling solutions, and complete turnkey design, construction and operation of minerals processing and energy projects. The full year result showed resilient margins, outstanding cash conversion, and plenty of balance sheet capacity (almost debt free). NWH briefly entertained making a bid for listed peer MACA Limited (MLD) during the month but prudently backed away from a bidding war against key competitor Theiss. The outlook for NWH remains strong with labour pressures easing, a strong order book and several opportunities across the mining, civil and MET divisions which ought to underpin another record result in FY23. NRW remains a core portfolio holding as we consider the share price move during the month has scope to push higher in the coming months on continued strong execution of the project pipeline and conversion of upcoming material opportunities into contracted work.

**Autosports Group Limited (ASG, +17.2%)** was a strong performer during August after posting a result that exceeded market expectations. ASG is a well-managed founder-led retailer of new and used prestige and luxury vehicles, providing both front-end and back-end products and services including aftermarket, parts and servicing and finance and insurance products to customers. Supply constraints are still a material issue across the automotive industry and the imbalance between new car sales and physical deliveries continues to track above 25% on a monthly basis for ASG. The upshot of this is that the company's order book continues to grow and used car prices remain high. This clearly bodes well for gross margin remaining elevated as there is no need for ASG to discount sales or enter into price negotiations with

purchasers. Moreover, the embedded gross margin on ASG's order book is well above FY22 levels as the brands that have long lead times that comprise the bulk of the order book are disproportionately skewed to the high-end prestige cars which have been in high demand. The outlook for parts and services divisions into FY23 is robust with pent-up demand from COVID-19 lockdowns still a tailwind and this ought to contribute to solid earnings growth in FY23.

We are conscious of the challenging macro-economic outlook and the traditional correlation between house price movements and new car sales. We are therefore keeping a watchful eye on the data as interest rates ratchet up. Our numbers assume that demand for new vehicles could moderate somewhat into CY23 if the Australian economy slows down and the housing market continues to fall, and the consumer environment softens. Nevertheless, our internal modelling suggests consensus analyst forecasts for FY23 are too low and we expect the stock to continue to re-rate as the sell-side analysts adjust their numbers upwards as the year progresses. At a share price of \$2.15, ASG is trading on a PE multiple of around 6x FY23 and a fully franked yield of 9% which remains attractive from an investment perspective.

**TPG Telecom (TPG, -15.6%)** traded lower after posting its half year result with the market negatively revising expectations for the full year (CY22). While TPG's longer term growth strategies remain on track and the COVID-19 related headwinds for its Vodafone mobile business are abating with the resumption of international travel, the company may be reticent to increase mobile plan prices in the near term to lift earnings while waiting for the ACCC to decide the fate of its proposed regional mobile network sharing agreement with Telstra. The proposed plan would see increased competition in regional areas where Vodafone's poorer coverage deters consumers and likely see TPG's Vodafone brand take share, particularly from Optus. While we see the agreement as in the best interests of consumers, Optus is vocal in its objection, which is likely to drag out the process longer than we had previously expected. Within the fixed broadband businesses (TPG and iiNet), the company's plan to move select customers away from low margin NBN infrastructure onto their own network, using wireless technology, saw slower take-up in the first half due to a global shortage of the chipsets that go into the customer premise equipment required. This equipment delay has been resolved and we expect the margin accretion from increased take up of fixed wireless services to offset the residual decline from the few remaining copper based legacy services in the future. TPG also announced the acceptance of its functional separation plan to allow wholesaling of its fixed fibre network with the aim of driving greater utilisation. While the market was

enthusiastic about this business for Uniti Group, the market is yet to ascribe much value to it within TPG, partly because of the lack of growth options before functional separation.

## Outlook

The equity market rally stalled in late August as it became clear that key central banks including the US Federal Reserve (the Fed) and our own Reserve Bank of Australia (RBA) remained firmly focussed on reducing inflation back to within the targeted bands. The market had rallied since July on the belief that the aggressive global market sell-off had been overdone and that central banks would begin to moderate rate increases in the coming months before eventually cutting rates in the back half of next year. Given the strength of the employment market and the overall economy in the US and Australia, we remained of the view that this was unlikely outcome and the Fund stayed the course with its defensive portfolio positioning. The Fund's solid performance over July and August was therefore the result of excellent portfolio specific news, as opposed to 'timing' the market and pivoting the portfolio for the short and sharp bounce that transpired.

The good news is that we have been well positioned as the market has recommenced its decline. Fed chairman Jerome Powell's succinct Jackson Hole address was the catalyst for the sharp reversal in markets as he made it abundantly clear that inflation remained public enemy number one for the US central bank. The US employment market remains very strong, albeit we saw some moderation in the jobs data last week. Against this robust economic backdrop, it remains clear that the Fed will continue to hike rates until such time that it becomes apparent that the inflation dragon has been slayed. With the Fed also beginning Quantitative Tightening (QT) in September, which will serve to reduce liquidity in the system, it presents a particularly challenging backdrop for risk assets including equities. As a result, the Fund remains conservatively positioned from both a sector positioning and cash weighting perspective. The risks of a US recession are elevated, and we retain minimal direct US exposure in the portfolio. Europe and the UK face an even more challenging outlook with stagflation setting in and a monumental energy crisis likely to send the region into a protracted recession over their winter. Readers will be aware that we have been bearish on Europe and the UK for some time and have limited exposure to that region in the Fund.

Our own central bank, the RBA, is charting a similar course to its US counterpart with the rhetoric coming out of Martin Place now remarkably similar. Notwithstanding a falling residential property market and deteriorating consumer confidence, the domestic economy, including

the jobs market, remains on solid footing. The RBA has made it clear that rates will continue to move higher until such time that inflation is in check. On Tuesday, the RBA increased the cash rate a further 50 basis points to 2.35% which is the highest level we have had since 2013, when it was 2.5%. It is also the first time the RBA has undertaken five consecutive rate increases since it adopted the 2-3% inflation target back in 1990. Whilst Governor Philip Lowe made it clear that the pace of future rate increases will be 'data driven', it seems more likely than not that we will get another 50-basis point hike at the RBA's October meeting, especially with June quarter GDP printing at an impressive 0.9% or at 3.6% year on year since the RBA's commentary. Whilst these interest rate increases will inevitably slow the Australian economy, we continue to believe that our country is better placed than Europe or the US to avoid a recession. Key commodity prices remain strong, particularly coal, oil and gas and soft commodities. For instance, BHP is reported to have paid \$18.5b in taxes and royalties alone to the Commonwealth in FY22. The national accounts are in good health and we are a rare global beneficiary of high commodity prices which leaves the Federal government well positioned to stimulate the economy should the necessity arise.

Reporting season has just wrapped up and it was refreshing to meet company management teams in person, after several years of online meetings. Despite the strong rebound in equity markets in July, the Fund was conservatively positioning heading into August given our view that we had yet to see the macroeconomic headwinds reflected in company profit margins, as well as our concern about their implications for forward looking earnings expectations.

Overall, reporting season was better than expected in the domestic small-cap space and the Australian economy remains robust despite the well documented challenges. For instance, it was interesting to observe that the consumer discretionary sector, a space which we had been cautious on heading into results, reported better than expected results. Moreover, solid trading amongst retailers has generally continued into July and August (e.g. recent trading statements from Baby Bunting, Nick Scali and Universal Stores), albeit against a locked down prior year comparison and with the usual caveats from management about the uncertain economic environment ahead.

From a consumer perspective, a common area of softness in results was in the e-commerce space, where companies continue to cycle one-off benefits that they experienced during lockdowns. The New Zealand economy was typically observed as being softer than the Australian economy (e.g. commentary from Nick Scali, Bapcor and Adairs) reflecting the impacts of longer lockdown periods,

lower levels of government stimulus, a more advanced interest rate tightening cycle and a different economic mix with lesser commodity price windfalls.

Labour shortages and wage inflation were perhaps the most frequent callouts during the company meetings and calls we attended during the period. Labour cost pressures that companies are seeing at present reflects not only the level of wage increases driven by mandated minimum wage regulations but also a lack of labour supply. Supply has been constrained by two years of border restrictions and lockdowns resulting in minimal levels of net migration of skilled labour. Examples of this include Symbio Holdings and Aussie Broadband which called out +8% wage inflation in their employee bases as they fight to retain talent. In addition to tight wage pressure, it is noteworthy that some companies are looking to attract workers in other ways. Labour markets are highly competitive and innovative companies are going to great lengths to attract and retain their number one asset: their people. For example, Mineral Resources have built a new \$100m plus head office in Perth to attract and retain key talent. The world class head office includes a fully subsidised café and restaurant, a commercial grade gym, free child-care, family zone for parents and a wellness facility providing medical and psychological services.

Supply chain challenges and employee absenteeism were also called out by many companies during the month as an issue in FY22, with both continuing to weigh on the outlook in many instances. With respect to supply chain constraints, we continued to see delays in the delivery of capital goods to customers, such as new cars, heavy mining equipment and IT hardware. To compensate many companies have built up customer order books to record levels. In industry parlance, companies have moved from a 'just-in-time' inventory policy to a 'just-in-case' policy. Whilst supply chain bottlenecks and port congestions are slowing ameliorating and freight prices seem to have peaked for now, we are keeping a close eye on the inventory positions of a number of companies (e.g. City Chic Collective, Kogan Limited and Adairs Limited) which may be forced to write down or clear inventory at a discount if the demand environment drops away.

With interest rates rising rapidly, balance sheet health was a key focus of the OC Fund's team, particularly in assessing cyclical companies where a drop in demand brought about by an economic slowdown could lead to debt covenant stress. Overall, corporate balance sheets appear to be in the best shape they have been in many years. A combination of government handouts during the pandemic and strong operating performances in recent years had left most balance sheets in rude health. Indeed, a number of companies with strong confidence in their

outlooks and robust balance sheets announced stock buybacks during the period (e.g. Eagers Automotive, Omni Bridgeway and Ridley Corporation) which were generally well received by the market. Companies with excess capital should be well placed to weather any macro-economic weakness and emerge stronger from a competitive perspective with the ability to make well priced acquisitions in the coming 12 months.

Overall, we continue to see the near-term macro-economic and geopolitical outlook as uncertain. Reporting season certainly had an element of 'kicking the can down the road' from management, with the lack of outlook commentary from many small caps moving investor focus to the next update from companies at either the upcoming AGM season or interim results period in February.

Little has changed with our portfolio positioning during the month with an overriding focus on quality business models at reasonable valuations continuing to provide a margin of safety. Our preferred portfolio themes include:

- Quality businesses that can grow their earnings outside of the economic cycle, e.g. APM Human Services International, Ventia Services Group and Ebos Group;
- Companies with pricing power that can weather a sustained increase in inflation, e.g. Elders, Pexa Group and Worley; and
- companies that have either actual infrastructure or 'infrastructure-like' assets that ought to continue to generate solid, predictable long-term cashflows: e.g. Auckland International Airport, Kelsian Group and TPG Telecom.

There are a raft of quality growth companies with long-term structural growth drivers that may become attractive if the market continues to sell-off aggressively. These include some of the higher quality online businesses (REA Group, Domain Group Holdings, Carsales.com and Temple & Webster Group) and defensive global growth companies such as Domino's Pizza Enterprises. These stocks have all sustained material share price falls this year and screen well under our investment process in terms of operational risk assessment but, until recently, had been valued above what we see as an attractive entry point.

We remain cautious on the consumer environment as we expect cost of living pressures, higher interest rates and a softer housing market to impact household discretionary spending. Shareholders of retailers are likely to be nervous about trading updates during late December as we head into the important Black Friday and Christmas trading periods. Looking further into CY23, cyclical stocks

such as retailers and niche financiers are likely to require macro conditions to stabilise, and the rates cycle to show signs of peaking before outperforming.

The Fund remains ‘cashed up’ at present, with a cash balance in-excess of 10%, providing ample flexibility to capitalise on any pull back in the market in the coming months. Whilst this level is well above our typical cash weighting of around 4-6%, we feel it is prudent in view of the elevated macro-economic and geo-political risks which could provide a cheaper entry point into stocks in the coming months, with some of the quality names in the small-cap space on our radar. Post our reporting season management catchups, we will once again head out on the road with an extensive company visitation program planned in the coming two months. 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<sup>#</sup>

Company	ASX code
APM Human Services	APM
Eagers Automotive	APE
GQG Partners Inc	GQG
Mineral Resources Limited	MIN
Seven Group Holdings	SVW

<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 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.

<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.

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