Fund up 2.6% for the quarter

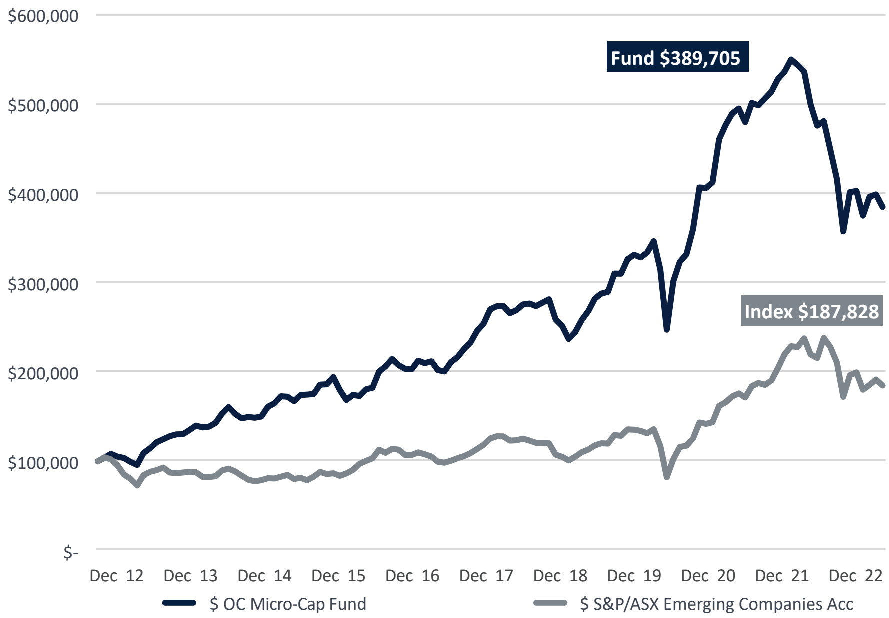
2.6%

Returned 14.6% p.a. for the past 10 years

14.6%

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 Dec 2022†	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.	Incep. % p.a. (Nov 2003)
OC Micro-Cap	-3.5	2.6	-28.4	4.9	7.4	14.6	12.6
S&P/ASX Emerging Comp. Accum	-3.6	2.6	-22.5	12.3	8.2	6.5	5.9
Outperformance	**0.1**	**0.0**	**-5.9**	**-7.4**	**-0.8**	**8.1**	**6.7**

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 31 October 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 cum-distribution end-of-month soft-close mid-prices and do not allow for the effects of income tax or inflation.

Performance review

Equity markets across the globe endured a challenging December rounding out a tough year for most asset classes. Stocks, bonds and property all suffered material falls in 2022 as the era of cheap money came to an abrupt halt with central banks ratchetting up interest rates in response to rampant inflation and reversing accommodative policies that had underpinned asset price strength in recent years. Stock markets across the globe fell steeply with several key bourses finishing at or near bear market territory including the US Nasdaq Composite (-33.1%), the US S&P 500 (-19.4%), China's blue chip CSI Index (-21.6%), and the MSCI All-Country World Index (-19.8%).

The OC Micro-Cap Fund has likewise endured a difficult year with micro-cap industrial stocks in the eye of the storm as many companies in the space were sold down aggressively over the course of the last 12 months. The Fund finished the year down -28.4% which was behind the broader S&P/ASX Emerging Companies Accumulation Index which fell -22.5% over calendar year 2022. The solid relative performance of early-stage resource stocks during the year was the main reason the Fund lagged the micro-cap benchmark Index. Eight of the 10 best performing stocks in the broader Index were early-stage resource stocks including Core Lithium, Lake Resources, AVZ Minerals, Arafura Rare Earths, Jervois Global, Argosy Minerals, Sayona Minerals and Tietto Minerals who contributed a combined +6.1% to the micro-cap Index in 2022. Rounding out the top ten were Neuren Pharmaceuticals and Silex Systems which in our view are more speculative in nature at this juncture, are currently unprofitable, and are also above our $500m market cap threshold for Fund inclusion; these two stocks contributed a further +1.7% to the Index performance. Investors will be aware that we typically screen these types of stocks from our investment universe due to their elevated risk profiles. There are periods where this can cause our performance to deviate from that of the Index and 2022 was such a year.

Despite the challenging macro-economic outlook, valuations have fallen sharply within the micro-cap investment universe, particularly in the profitable industrial space which is our core investment universe. We remain optimistic that calendar year 2023 will be much better for the Fund and our investors.

Elmo Software (ELO, +115.6%) attracted a takeover bid during October and was a strong contributor to overall portfolio performance during the quarter. ELO is a leading vendor of integrated cloud human resources, payroll and rostering/time and attendance software operating in Australia, NZ and the UK. ELO targets customers in the mid-market (>50 employees) and SME (<50 employees) segments. On 26 October, ELO announced its entry into a Scheme Implementation Deed with K1 Investment Management (K1) for the acquisition of 100% of ELO's issued capital at $4.85 cash per share, which represented a 100.4% premium to ELO's $2.42 undisturbed share price. K1 is a US-based enterprise software focused private investment firm which has closed 34 investments in the last twelve months and has invested in over 200 enterprise software companies since inception. ELO's board unanimously recommended that shareholders accept the offer in absence of a superior proposal and major shareholders representing 34.4% of ELO's register have announced their intention to vote in favour of the proposed offer. ELO was added to the portfolio in July when we recognised it as representing excellent value (at approximately $220m market capitalisation and with net cash of $48m) versus the estimated $380m ELO had invested in the business since its ASX listing in 2016, despite maintaining strong organic revenue growth. Whilst we would have preferred to see ELO scale into being a highly profitable tech business in the coming years, we also recognise the solid premium of the K1 takeover offer and we will be accepting the bid in the absence of a superior proposal.

Telix Pharmaceuticals (TLX, +53.7%) re-rated materially during the quarter after announcing a series of positive commercial, regulatory and trial/study related milestones. These included:

- Positive Phase III ZIRCON study results for TLX's renal imaging agent (TLX250-CDx) with the trial meeting both primary and key secondary endpoints. This opens up a total addressable market (TAM) of +US$500m annually with no competing product currently approved in the space and with the company expected to move towards FDA approval in late CY23 and commercial launch in H2 CY24;
- Second quarter of commercial sales for Illuccix, TLX's PET imaging agent, surprising on the upside in the critical US market. TLX reported Illuccix sales in the US of US$36.4m in Q3 CY22 versus US$13.6m in Q2 CY22, which was around 10% ahead of consensus expectations;
- Regulatory approval for Illuccix in the Canadian market for prostate cancer imaging, the first PET imaging agent to be granted regulatory approval in that market; and
- The approval by the Chinese regulator of an application to commence a pivotal phase 3 study for Illuccix in China for the imaging of recurrent prostate cancer.

TLX significantly reduced its cash burn during the third quarter with quarterly net operating cash outflows of A$5.3m, a material improvement on A$25.8m in the previous quarter and the company now looks to be controlling costs well. Importantly, we now expect TLX to be EBITDA positive in FY23 and profitable in FY24. Following a capital raising of $175m in January 2022, TLX remains well funded to execute on its robust pipeline of additional material opportunities in the growing field of radiopharmaceuticals which is attracting far greater attention from investors and regulators.

MMA Offshore (MRM, +38.4%) share price moved higher during the quarter as it provided a buoyant trading update that further illustrated that this once highly distressed capital equipment provider is firmly back on track and highly leveraged to offshore energy market tailwinds. MRM contracts out vessels, and provides marine and subsea services, to the offshore energy, renewables, and wider maritime industries in Australia and internationally. MRM operates a modern, world leading fleet of 24 vessels and has 1,100 employees operating out of six facilities globally. MRM also carries a number of non-core vessels held for sale and recent realisations suggest asset values in the sector are only strengthening. OC acquired its position in MRM at a deep discount to its prevailing NTA in late 2020, when its balance sheet required re-capitalisation, through a $93m capital raising and a restructure of its debt facilities which included a term extension, covenant waivers and $15m of debt forgiveness from its syndicate of lenders. As a result of recent strong sectoral trading conditions and asset sales, the MRM net debt position is now at a quite manageable level of $30m (against a market capitalisation of $350m) and represents approximately 1x 2022 EBITDA. MRM was traditionally seen as a service provider to the offshore oil and gas sector and leveraged to hydro-carbon market conditions. In recent years, MRM has expanded its offering into the burgeoning offshore wind turbine market and is also increasingly servicing the government and defence sectors through offshore surveys and infrastructure work. MRM is beginning to reap the benefits of this diversification strategy whilst also retaining exposure to its traditional hydrocarbon market. MRM's trading update showed earnings for the first half up +70% on the prior corresponding period with vessel utilisation above 80% (and up to 90% in some divisions) being the primary contributor to the uplift. MRM is now trading around its NTA, after a prolonged period at a significant discount to NTA, and whilst we have reduced our position accordingly, MRM remains a core portfolio holding offering unique exposure to offshore energy market investment.

Communications service provider **Symbio Holdings (SYM; -50.9%)** was down for the quarter after announcing a surprise downgrade late in December. SYM previously guided to FY23 EBITDA of $36m to $39m in August 2022 before reiterating guidance at its AGM in early November. Since early November, SYM experienced lower than expected customer demand and slower than expected new customer wins which led to a disappointing 25% reduction in forecast FY23 EBITDA to $26m to $30m. Whilst SYM is still growing top line revenue, this growth is less than expected in a period when SYM is aggressively growing its cost base to support a long-term Asian growth strategy. Whilst the Asian growth strategy is appealing, a key premise for the investment in SYM was that revenue should be largely recurring with structurally driven growth. Lower customer demand following COVID-19 related bulk orders in 2021 means this premise is no longer valid. Furthermore, whilst SYM will maintain a material net cash balance in June 2023, given the company is also capitalising a large amount of technology development, free cash flow is likely to be de-minimis in the near term. Earlier this year we had actively reduced the position into the FY22 result, as expectations had been revised lower previously. Following this disappointing update, we have elected to exit the position completely. We will continue to monitor SYM and re-assess if the company can execute on market entry into Singapore, Malaysia and Taiwan which may be a catalyst for us to consider reinvesting in the stock.

Outlook

As we enter the new year, the critical question is undoubtedly how much the global economy will slow as a result of the interest rate increases that have been necessary to combat inflationary pressures and whether it will bring about a recession. Key central banks including the US Federal Reserve (the Fed), the European Central Bank (ECB) and our own Reserve Bank of Australia (RBA) have made it abundantly clear that the battle against inflation is not yet won and that there are more rate increases to come. To be clear, notwithstanding signs of weakening activity and moderating inflation, central bankers will continue to tighten monetary policy. The ability of the economy to absorb further rate hikes remains to be seen with the lagged impact of monetary policy meaning that the worst of the economic slowdown likely still lies ahead of us. The challenge, therefore, for the central banks as we enter 2023 is to return inflation to an acceptable level without breaking the economy and causing a hard landing.

Equity markets have held up well in the second half of CY22 given the macro-economic and geopolitical pressures, but with the economy likely to slow at an increasing rate, we expect company earnings for cyclically exposed businesses to come under increasing pressure in the months ahead. This will make our job as stock pickers a crucial one in CY23.

In the key US economy, the Consumer Price Index (CPI) printed at +7.1% in November, cooler than had been expected for the second consecutive month, although household staples such as shelter and food remained among the largest contributors to consumer price rises. Whilst it is off recent highs, inflation is nevertheless proving “stickier” than the Fed would have hoped suggesting that more rate pain lies ahead. In mid-December, the Fed hiked the benchmark federal funds rate to a range between 4.25% and 4.5%, a 15 year high. Fed Chair Jerome Powell said recent cooling of inflation was a “welcome reduction” but “it will take substantially more evidence to give confidence that inflation is on a sustained downward path”.

The US economy has until recently remained resilient with the unemployment rate near record lows (3.7% in October), although signs of consumer softness and a moderation in housing activity suggest that economic activity is likely to cool rapidly and leading indicators such as consumer sentiment, mortgage demand and lending standards foreshadow that the US consumer is likely to weaken further in the near term. Fed officials now expect the federal funds rate to peak between 5.0% and 5.5% in calendar 2023, implying a further 75 basis points in rate rises from here. We remain of the opinion that it will be a difficult task for the Fed to orchestrate a soft landing for the US economy against a backdrop of rapid rate hikes, elevated and sticky core inflation and a slowing economy. The OC Funds portfolio consequently remains underweight US exposure heading into the new year.

On the domestic front, while the housing market has responded to swift monetary policy tightening, the broader economy and inflationary pressures are taking time to adjust. Notwithstanding a falling residential property market and deteriorating consumer confidence, the domestic economy, including the jobs market, remains on solid footing. In early December, the RBA increased the cash rate a further 25 basis points to 3.1%. Whilst the RBA remains more dovish compared to other central banks, there is an expectation that the current pace of rate hikes will continue until mid-2023, with expectations of the RBA cash rate peaking around 3.6%.

While forward indicators across certain sectors are suggesting inflation may be moderating, we are yet to be convinced that inflation can be tamed without impacting company earnings into CY23. Whilst the path to a soft-landing in Australia has narrowed, a near 50-year low unemployment rate of 3.4% and a healthy but falling household savings rate still leaves domestic consumers in a solid position even after allowing for near-term inflationary pressures, rising interest rate rises and a softening housing market. Australia still looks better positioned than many of its global peers to avoid a recession, although we expect that a material slow-down in the global economy is making the RBA's task incrementally more difficult.

Despite the economic challenges that lie ahead, which have been well documented in our recent monthly reviews and by central banks and the mainstream financial media, the sell-off across core micro-cap investment universe has been severe over the past 12 months. This has led to some attractive investment opportunities beginning to emerge, notwithstanding the economic outlook. We have begun selectively adding quality stocks such as Aussie Broadband and RPMGlobal Holdings to the portfolio over the past quarter. Our overriding focus at present remains on investing in quality businesses at reasonable valuations that ought to have resilient earnings in a slowing economy.

As we enter the new year our preferred portfolio exposures include:

- companies that can grow their earnings outside of the economic cycle including Pacific Smiles Group and Probiotec Limited;
- companies with pricing power that are well positioned to pass on cost pressures to their customers or outperform in an inflationary environment including Propel Funeral Partners and Silk Logistics; and
- quality companies with solid long-term growth profiles or structural growth, that have been sold down to attractive entry points, such as Aussie Broadband and RPMGlobal Limited.

Following a busy year for the investment team, January typically provides some welcome respite as we enter the blackout period for companies with either June 30 or December 31 financial year ends. This effectively means that communication from companies to investors is limited to non-financial matters until the release of results in February.

We would like to thank our investors for their support through what has been a difficult year across equity markets and a challenging year for many people personally with the spate of natural disasters impacting the country, as well as ongoing COVID-19 related challenges. We wish all our investors and their families good health and good spirits as we enter the new year. As managers and investors in the Fund, we are upbeat on the prospects for the OC Funds portfolio heading into the new calendar year and we remain confident in our ability to achieve consistent strong long-term returns.

Top 5 holdings#

Company	ASX code
Cedar Woods Prop.	CWP
Probiotec Limited	PBP
Propel Funeral	PFP
Silk Logistics	SLH
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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