

 Fund down -4.6% for the month

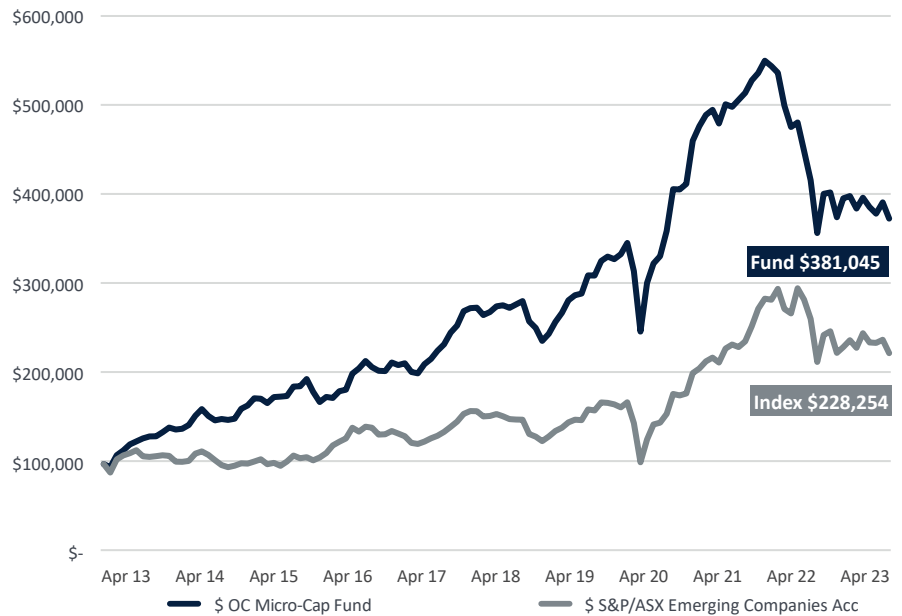
-4.6%

 Returned 14.3% p.a. for the past 10 years

14.3%

 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 May 2023*	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	-4.6	-3.4	-10.3	5.0	6.3	14.3	12.2
S&P/ASX Emerging Comp. Accum	-6.3	-5.1	-14.8	16.1	7.7	8.6	5.7
Outperformance	1.7	1.8	4.5	-11.2	-1.3	5.7	6.5

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 hard-close mid-prices and do not allow for the effects of income tax or inflation.

Performance review

May lived up to its reputation as a difficult month for equity markets as sticky core inflation and rising interest rates began to take a growing toll on leading economic indicators across global markets. Stock markets were also jittery ahead of the US Congress' latest legislative action to raise the government's borrowing limits, with the gravity of a potential default further reinforcing a 'risk-off' bias across the back end of the month. Key global bourses including the US Dow Jones (-3.5%), the UK FTSE (-5.4%), the Hong Kong Hang Seng (-8.3%) and the Chinese Shanghai Composite (-3.6%) sold off heavily. The US tech heavy Nasdaq bucked the trend and rallied 5.8%, fuelled by a stunning result from chip maker NVIDIA which lifted sentiment to other big-tech stocks exposed to the artificial intelligence (AI) thematic including Microsoft Corporation and Alphabet (Google's parent company).

The domestic micro-cap equity index too was under pressure throughout May. A raft of profit warnings across the retail space, including from City Chic Collective, Adairs, Best and Less Group Holdings, Dusk Group and Universal

Store Holdings spooked investors and liquidity remained below average for much of the month. The S&P/ASX Emerging Companies Accumulation Index finished sharply lower for the month (-6.3%). The OC Micro-Cap Fund managed to comfortably outperform the index but still fell -4.6%.

OC Funds Management is pleased to announce the nomination of the OC Dynamic Equity Fund for the prestigious 35th Annual Money Management Fund Manager of the Year Awards in the Australian Small Cap Equity category. This recognition reflects the Fund's strong performance and dedication to delivering outstanding results to its investors. The Money Management Fund Manager of the Year Awards is a highly regarded industry event that acknowledges excellence in the investment management industry. It is Australia's longest-standing independent and 'whole-of-market' fund awards program. The Small Cap Equity category specifically focuses on funds that demonstrate exceptional expertise in navigating the dynamic and

challenging small-cap equity market segment. The Fund's nomination (alongside two other Funds) follows on from the OC Premium Small Companies Fund's recent nomination in the Morningstar Fund Manager of the Year awards in the Domestic Equities – Small Caps category. It underscores the team's consistent track record of success in managing small-cap and micro-cap investments over a long time horizon. It also marks the fourth time since 2018, when OC Funds Management actually won the award, that OC Fund's has been nominated as a finalist in the Australian Small or Small/Mid Cap Equity Fund of the Year category at the Annual Money Management Fund Manager of the Year Awards.

Bigtincan (BTH, +31.7%) gapped higher after an article in the *Australian Financial Review* reported that the company had received a second confidential non-binding, incomplete and indicative offer to buy the company at \$0.80 per share (following on from a similar offer in 2022). BTH is a small position in the Fund which we bought in FY23 when cash burning, growth companies were heavily out of favour. BTH has since fielded two indicative takeover offers from two separate private equity firms, each of which are well known investors in the technology sector. BTH is running a process which is evaluating a potential change of control transaction and it has not progressed either of these non-binding, indicative offers at this stage. To recap, BTH provides software for large and medium corporates which enables sales teams to deliver improved buying experiences for potential customers. BTH has a strong balance sheet and has recently reaffirmed to the market that it will reach cash flow break even by Q4 CY23. BTH remains a small position in the Fund given the stage of the development of its business model and the highly uncertain, albeit persistent, takeover interest from third parties.

Smartpay Holdings (SMP, +10.3%) rallied during the month after a strong FY23 result highlighted EBITDA growth of 81% (driven by revenue growth of 62%) which was matched by a more measured and slower rate of growth in costs. This operating leverage is a function of both a fast payback on new customer acquisition costs and disciplined investment by the SMP management team. We believe strong revenue growth and margin expansion can continue into FY24. SMP also delivered strong operating cash flow conversion and free cash flow which is impressive given that its growth requires an initial capital investment in the form of providing a payments terminal to new SMP customers at no charge. SMP also provided further colour on its New Zealand business where Small to Medium Enterprises (SMEs) currently pay SMP a terminal rental fee but are also required to pay higher merchant service fees directly to their merchant acquirers and processors than SMEs in Australia. SMP believes it will be able to offer a simpler and cheaper product to its 31,000 existing customers

in NZ over the next calendar year which could drive even higher earnings growth in the medium term. We have also recently spoken to SMP's payment 'switch' or processing partner Cuscal to further understand this opportunity. We remain upbeat on the outlook for the SMP business and have retained our position despite the share price strength.

Top Shelf International Holdings (TSI, -48.9%) was sold down heavily following a series of actions taken by major shareholders (OC Funds included) and backed by the board which ought to position the company with both the management team and the funding to reach profitability in the coming years. These actions have included:

- The appointment of Trent Fraser as Managing Director, stepping up from his role as President Agave and International. Mr Fraser has more than two decades of experience in wine and spirits, including 13 years in New York at LVMH, the world's largest luxury goods company, as well as almost a decade with Penfolds and Treasury Wine Estates in Australia.
- An institutional placement of \$19m, with cornerstone support from existing major (and new) shareholders, subject to shareholder approval at a General Meeting to be held in late June.
- A \$21m accelerated non-renounceable entitlement offer, contingent on shareholder approval of the placement, immediately following the General Meeting.

Whilst the raising is messy and painful given the share price fall, it ought to leave TSI with minimal debt and provide the funding runway to execute the operational plan and establish a profitable business model. Importantly, the equity raising removes the proposed sale and leaseback of the agave farm at Eden Lassie, thus retaining ownership of a key long-term strategic asset of the business.

Operationally, TSI continues to grow revenue and recently increased its ranging of both NED Australian whiskey and Grainshaker Australian vodka within the Coles Liquor group. We also believe the company is close to securing shelf space for NEDs with the market leading Endeavour Group which counts Dan Murphy's and BWS amongst its stable. To date, TSI has been a poor investment for the Fund and execution, particularly on the cost side of the ledger, has been underwhelming by the (now) former Managing Director. In hindsight, we invested too soon in TSI's listed journey. That said, we continue to believe the company's quality stable of brands leaves it well positioned to attract the attention of global majors in the coming years and a successful capital raise will leave the business sufficiently funded and well positioned to achieve its potential.

Youth fashion apparel retailer **Universal Store Holdings (UNI, -39.8%)** sold off significantly on the back of a weaker than expected trading update delivered in late May. While the stock price had drifted lower since the February result, reflecting the deteriorating retail conditions caused by ongoing inflation and interest rate tightening, the stock gapped down further on the announcement of the trading update. Following the downgrade from UNI, other listed retailers including Adairs, Baby Bunting Group and City Chic Collective also published soft trading updates reflecting a broadly weaker retail environment. Aside from consumer belt-tightening, the other news in the retail sector was the 5.75% average increase in the award rate (directly impacting UNI's wages bill). While this is an additional headwind for the retail sector, it was not unexpected with the company already budgeting a significant increase into its revised guidance and working on rostering to ensure stores are staffed correctly for the demand level. Encouragingly for UNI, gross margins are holding up well and inventory remains at an appropriate level. Also, importantly for the investment thesis, even in the current environment, new stores being opened are profitable from month one so there is no change to the company's store rollout growth ambitions. We expect that UNI will continue to grow organically by new store roll out and by higher gross margins over time from increased own brand penetration. With the stock now trading on a single digit PE multiple with a solid balance sheet and paying significant fully franked dividends, we feel UNI is well positioned to weather the retail downturn and we will look to add to the position if we believe it becomes oversold.

Outlook

"Sell in May and go away" so the saying goes, and it again proved to be a challenging across global equity markets in the month of May. Sticky core inflation and rising rates in key western economies, combined with uncertainty around the US government's debt ceiling, conspired to drive equity markets lower. June has started more positively after the US Congress approved a deal to lift the country's borrowing limit, days before the world's largest economy was due to default on its debt. The Treasury Department had warned it would be unable to pay all its bills by Monday 5th June if Congress had failed to act by then. The markets staged a relief rally at the start of June with President Biden signing a bill that suspends the US government's \$31.4 trillion debt ceiling, averting what would have been a first-ever US default with just days to spare.

A positive US jobs report at the start of June has further coaxed some of the bears from their caves with last Friday's employment data showing that hiring stepped up in the US in May with 339,000 jobs added. This was unambiguously strong and demonstrates the resilience

in the US economy, despite more than a year of steep interest rate rises from the US Federal Reserve (the Fed). We temper this good news by noting that employment data is a lagging statistic, and it is likely that many employers are still engaging in so called 'catch-up' hiring following the COVID-19 pandemic particularly at food, hospitality and entertainment venues, where operators are restoring their workforce to pre-pandemic levels.

Our general observation would be that the US economy appears to be weakening, notwithstanding the robust job market. Economic growth (GDP) slowed to a 1.3% annual rate from January through March, after 2.6% annual growth from October through December and 3.2% from July through September. Although the Consumer Price Index (CPI) fell to 4.9% in April, the annual Core PCE Price Index, the Fed's preferred gauge of inflation, edged higher to 4.7% and remains stubbornly high. The widely watched Michigan Consumer Sentiment Index, a monthly survey of consumer confidence levels in the US, came in at 59.2%, down 7% for the month. This would seem to indicate that US consumers are becoming increasingly worried about the path of the US economy. The Fed's next move remains unclear and Federal Open Market Committee (FOMC) participants seem genuinely divided about the appropriate path of rates in upcoming meetings. Fed Chair Jerome Powell's comments suggest an openness to pausing rate hikes, although he remains data dependent. Other FOMC participants continue to view the economy as resilient, with inflation still unacceptably high, according to the minutes of the recent meeting. So, having imposed 10 straight rate hikes since March 2022, the Fed may well skip a rate hike when it meets later this month. We do, nevertheless, expect that the Fed will resume its rate hikes in the coming months until such time that it becomes clear that inflation genie is back in the bottle.

On the domestic front, several data points released during the month suggest that the Australian economy is rapidly cooling. Consumer confidence dipped sharply with the latest Westpac-Melbourne Institute survey showing consumer sentiment dropping 7.9%, from 85.8 in April to 79.0 in May. This was validated by the ANZ-Roy Morgan Consumer Confidence Index which fell 1.1 points to 76.2 in the last week of May, marking the thirteenth consecutive week that the indicator has been below 80, the longest such stretch since the index began being administered on a weekly basis in October 2008. A combination of the Reserve Bank of Australia's (RBA) surprise rate hike in May and a lack of cost of living relief in the May Federal Budget has seen consumer confidence fall sharply.

At the coal face of the economy, retailers are starting to feel the pinch with customers facing higher mortgage

payments, higher energy costs and other cost of living pressures from sticky inflation and, hence, are spending less. Consumer facing stocks downgrading earnings expectations during the month included a wide array of retailers such as City Chic Collective, Adairs Limited, Best and Less group, Dusk Group and Universal Store Holdings. There is no doubt that our discussions with retail contacts have turned more bearish in recent weeks. Retailers are cycling record levels of spending achieved in 4Q22 and 1Q23, which will provide an extremely challenging retail backdrop to cycle in the next two quarters. Whilst the sharp share price retracements from most listed retailers would ordinarily pique our interest, we feel it is too early to increase our exposure to the sector. The Fair Work Commission decision in early June, which delivered a 5.75% increase for award workers and the national minimum wage, will pose a further headwind for the downtrodden sector. The minimum and award wage decision directly impacts 14 per cent of the national wage bill and the industries most likely to be impacted by higher wages bills are retail, health care, hospitality, and support services where awards are heavily used.

In other economic news, Australia's building approvals hit an 11-year low during the month with data released by the Australian Bureau of Statistics indicating that the total number of dwelling approvals fell by 8.1% in April. Whilst this data series can be quite volatile, on face value it indicates that construction activity is falling sharply. There was an unexpected jump in the jobless rate during the month, with the unemployment rate climbing to 3.7%. Whilst the jobless rate remains near 50-year lows, it had buoyed hopes that the RBA might pause rates at its early June board meeting. The decision seemed far from clear-cut, with the surprise jump in the CPI in May to 6.8% driven by rising rents, a lift in holiday travel costs and higher transport costs adding weight to case for further rate increases.

The RBA surprised the market by lifting the cash rate to 4.1% on the first Tuesday of June, with money markets wrong-footed having forecast a 68% chance of a pause. The commentary from the RBA was incrementally more hawkish and very much focused on ensuring that inflation returns to target in a reasonable timeframe. The hike came despite clear evidence that economic activity is slowing, particularly household consumption as cost of living pressures bite. It seems unlikely that the RBA will pause its rates tightening here at 4.1%, with Governor Philip Lowe's statement following the board meeting reiterating that "Some further tightening of monetary may be required to ensure that inflation returns to target in a reasonable timeframe", although the RBA did caveat that it will depend upon how the economy and inflation evolve. There was even a tacit acknowledgement from the RBA that a domestic recession may be likely with the "path to achieving a soft landing...a narrow one".

No doubt the domestic economic backdrop has deteriorated of late, and the prospect of an Australian recession has increased with the cash rate likely heading north of 4.1%. Regular readers would know that our base case assumption, until now, was that we could avoid a recession and that the government has levers to stimulate the economy should it stall. The ability of the federal government to jump-start the economy is now even greater following the recent unexpected budget surplus and with strong ongoing bulk commodity prices providing even more windfall royalties and taxes to the Treasury department. Whilst avoiding a recession remains a possibility, whether Australia enters recession or just skirts it will make little difference to our overall portfolio positioning. The Fund has for many months been reducing its cyclical stock exposure. Instead, we have positioned our capital in stocks that can either grow outside of the economic cycle or have structural growth drivers that mean they ought to continue to outperform as the economy slows. We are continuing to add quality stocks to the portfolio as they fall to attractive levels. We are also becoming increasingly confident that this market downturn will sow the seeds for strong investor returns in the coming years as we add quality companies to the Fund at prices which we assess to be well below their intrinsic values. Market corrections are healthy and normal, and OC Funds has an excellent track record of delivering strong investor returns following these episodes.

Top 5 holdings[#]

Company	ASX code
Cedar Woods Properties	CWP
Peter Warren Automotive Holdings	PWR
Probiotec Limited	PBP
Silk Logistics Holdings	SLH
Telix Pharmaceuticals	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.

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 47, 80 Collins Street (North Tower), 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.