

At 31 August 2023	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Incep. % p.a. *
Chester High Conviction Fund (after fees)	-1.5	1.5	0.9	3.4	15.3	9.9	12.1
S&P/ASX 300 Accumulation Index	-0.8	3.9	2.9	8.9	10.5	7.0	7.6
Outperformance (after all fees)	-0.7	-2.4	-2.0	-5.6	+4.8	+2.9	+4.5

* 27 Apr 2017

“Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can’t buy what is popular and do well.” **Warren Buffett**

Month in review

We tend to find historically our highest returning ideas over the next 2-3 years have attracted the least amount of sponsorship. That is, they are the most unloved, uncrowded trades. We have many names that fit this framework with strong valuation support and pending catalysts, hence we remain optimistic as to how the portfolio performs from this point. We have added several names to the portfolio recently which we will touch on in the next quarterly.

From a macro perspective, the resilience in economic data remains surprising, while unemployment is the key metric as to how labour market weakness leads to any softening of wage growth, a key variable in the “stickiness” of inflation. The current strength in the oil price doesn’t help the dis-inflationary narrative. There are clearly mixed signals as to how the bond market prices interest rate expectations over the next 12 months, with consensus expecting a prolonged pause. We have been of the view that the US deficit spending (annualising at US2.7tn the past 3 months) and the decline in the savings rate (US household savings have fallen from US2.1tn in 2021 to US180bn currently) have underpinned the economic resilience so far in 2023, which we view as unsustainable. Combined with the lagged impact of rate hikes, we suspect FY24 will remain choppy, with data likely to weaken.

Reporting season in aggregate saw modest downgrades with the narrative of caution around FY24, in line with our thoughts above. The most successful strategy in August centred around growth and momentum stocks, albeit with a wide dispersion around those trends (Altium up 26%, Wisetech down 19%, Cochlear up 14%, Resmed down 24%). Discretionary stocks in aggregate saw a strong relief rally based on results being better than feared, whereby, we would view the next 12 months (unemployment rising, increased mortgage pressure) to be more challenging than the past 12 months. We touch more on reporting season trends on page 2, while asserting we find “in aggregate” comments to be rather unhelpful given very much the idiosyncratic nature of stock movements through August.

Portfolio review

During the month the fund returned -1.5% relative to the -0.7% fall in the ASX300. The strong performers in August were led by Aussie Broadband (ABB), demonstrating exceptional cash flow growth and continued momentum in residential broadband connections. Expectations, like many strong August performers, were cautious heading into the result. The pipeline of business or enterprise customers augurs well for continued FY24 growth. News Corp also performed strongly through August by demonstrating the resilience of earnings stemming not just from the realestate.com.au investment, but the Dow Jones business unit, which we view as a very strong franchise. The implied multiple for Dow Jones (if we strip out the NWS stake in REA) is circa 4-5x, while we believe the business should be valued closer to 11-12x EV/EBITDA,

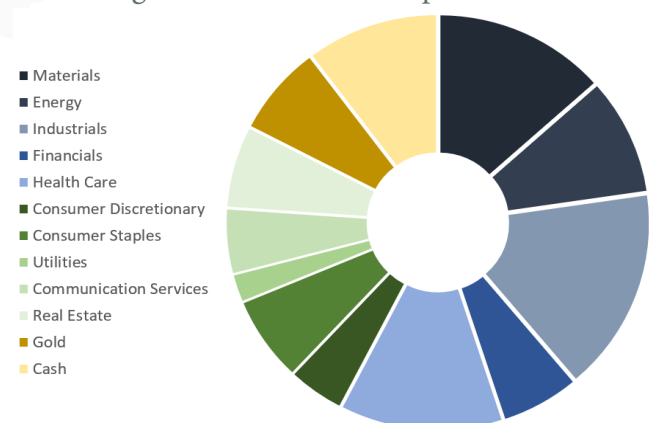
which continues our belief that the conglomerate structure of NWS materially undervalues the organisation.

Underperformers for the month were led by Resmed (RMD), which has become one of the most polarising valuation arguments we can recall. While the RMD quarterly was a slight disappointment from a gross margin perspective, the stock has fallen 28% since the result in response to the powerful narrative around weight loss drugs. The thesis being that these drugs (Ozempic, Wegovy, Mounjaro) if taken consistently over a 12-18 month period, can materially reduce obesity, and therefore the addressable market for Obstructive Sleep Apnea (OSA) will be significantly reduced in the coming 5-7 years, with obesity being linked to OSA. We will discuss this in more detail in the next quarterly, suffice to say, weight loss drugs are still very early in the lifecycle with many side effects still misunderstood. Mr Market has declared that RMD is guilty until proven innocent in terms of the medium term growth rates attached to OSA. At this stage, we tend to view this price weakness more as an opportunity than a threat. Austal (ASB), we continue to view as an asymmetric investment case below AUD2.00. Without question we have found it frustrating with a book value above AUD2.50 and a very strong revenue growth trajectory over the next 5 years given the recent contract wins that see the ASB order book at record highs. While FY24 guidance was slightly softer, it is a transition year as they ramp up towards the 2 new programs starting in mid 2024. We also note that guidance for FY24 was using an AUD currency of 0.72 vs the spot rate at 0.64. All else being equal, this would be a 15% eps upgrade at spot, but we are quite sure that no one is looking. The market remains materially below our own FY26 forecasts, which unfortunately, requires more patience.

Top 3 holdings	Portfolio breakdown	
CSL	Industrials	16.1%
Mineral Resources	Materials	13.4%
Austal	Health Care	12.7%

Top 3 portfolio attribution	Bottom 3 portfolio attribution	
Aussie Broadband	Resmed	
News Corp	Austal	
Brambles	Abacus Storage King	

Fund weights - diverse sector exposure



BROAD REPORTING SEASON THOUGHTS

OBSERVATION	IMPACT
ACCESS TO CAPITAL	Higher interest costs and increasing leverage ratio's in aggregate led to lower dividend payouts with corporates happier to be conservative around the outlook. Those with the strongest balance sheets tend to strengthen their industry position during these times.
STOCK SELLDOWNS	The window for executives to sell stock is now, between reporting results and the AGM season in October/November. We expect a wide array of CEO/CFO selldowns now before having to come back to the market with more clarity around FY24 trading. Insider confidence may be more telling for those that choose not to sell stock during this window.
CAPITAL MARKET ACTIVITY	Given the above points, we expect heightened activity over the coming months in ECM deals, both from an M&A perspective and a recapitalisation perspective. Given how resilient the market has been this year, many corporate deals may be dusted off to bolt on inorganic growth or shore up balance sheets that are suddenly too leveraged.
DE-PREMIUMISATION OR BIFURCATION?	Many consumption call outs on downgrading trends (shopping baskets, eating at home etc), SVOD offerings (Stan subscribers). Market is bifurcated in travel with older generations flush with assets happy to pay up for premium experiences. Many luxury brands still very resilient.
SHRINKAGE	In a sign of more challenging economic conditions, Coles specifically called out higher shrinkage (theft) on the CODB (cost of doing business). This is consistent with many retailers (more so in the US) that have seen significant shrinkage in a trend unlikely to reverse unless the activity is punished.
COVID HAS BEEN CYCLED?	We have spent some time observing margin trends for all companies from 2018-2023 in identifying those stocks/sectors that have experienced tailwinds or headwinds from the pandemic dislocation. It appears to us that many retailers (JBH, PMV, SUL) are still overearning from previous margin experiences, while many healthcare names (CSL, RHC) are still seeing margins significantly below pre COVID levels. An opportunity or a threat?
PRICING POWER	We have also spent significant time considering whether firms have genuine pricing power (realestate.com.au), or cyclical pricing power given shortages over the past 2 years of goods they supply (car dealerships, insurers, building materials). How sustainable are pricing pass throughs? There is a large dispersion in many cases as to the perceived "quality" of the top line resilience.
WEATHER PATTERNS EL NINO VS LA NINA	Appears to be a structural cycle change occurring in the northern hemisphere, with expectations for an Australian summer to be significantly drier than the previous 3 years. Weather had a significant impact on many ag, insurance, industrial and building material companies in CY22, potential for a far easier 1H FY24 for many.
PROPERTY	Household formation remains the biggest policy challenge facing Australia. The outlook for housing construction activity remains subdued, which is at odds with the immigration led population growth. The upward pressure on rents will act as a headwind for the RBA inflation target. From a REIT perspective, our biggest surprise was the lack of cap rate expansion across all sectors. Broadly speaking, we think valuations are still too aggressive for the interest rate cycle. With a cash rate at 4.1% and a 10 year yield around the same level, property cap rates should at a minimum, start with a 6% in front of it.
LABOR FORCE	In broad terms, far fewer companies cited real labor shortages as a significant challenge, suggesting to us, the challenge hasn't been solved yet, but the crisis of labor shortages has probably peaked. Not too many corporates were willing to call out significant headcount reductions yet, which is at odds with what we are hearing privately. Headcount is a variable cost in many cases that may need focus if conditions deteriorate.
CAPEX	Most resource companies (BHP, PLS, MIN) called out higher project costs for expansions, with many 10-15% increases in the capex bill for major projects. Next DC called out a significantly higher capex number as well, underpinned by unmet demand. Free cash flow growth is more important for some sectors than others.

Accumulated Performance by Financial Year - Same Strategy

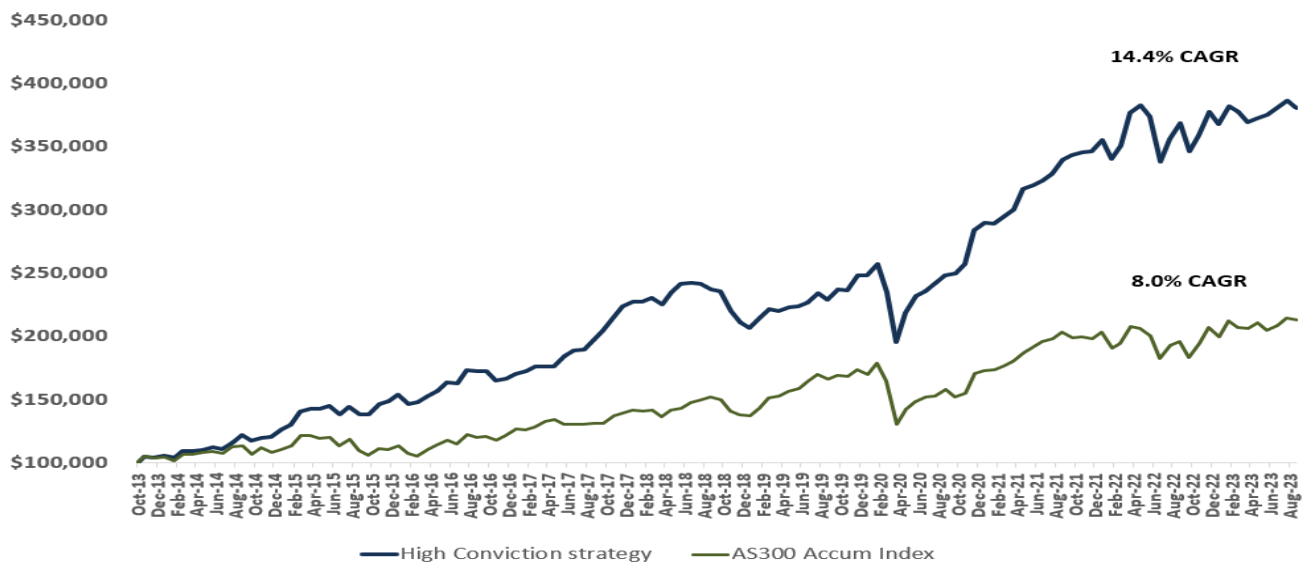
	FY14 (%)#	FY15 (%)	FY16 (%)	FY17 (%)*	FY18 (%)	FY19 (%)	FY20 (%)	FY21 (%)	FY22 (%)	FY23 (%)	FY24 (%)	Inc (%)
Same Strategy (after MER)	+11.2	+24.5	+17.4	+11.2	+28.3	-6.4	+3.9	+37.2	+4.8	+12.5	+0.0	+14.4
S&P/ASX 300 Accum Index	+7.8	+5.6	+0.9	+9.1	+13.2	+11.4	-7.7	+28.5	-6.8	+14.4	+2.1	+8.0
Value added (after MER)	+3.5	+18.9	+16.4	+2.1	+15.1	-17.8	+11.6	+8.7	+11.6	-1.9	-2.1	+6.4

Per Annum. The inception date of SGH Australia Plus was the 8th of October, 2013, where Rob Tucker was the sole Portfolio Manager, until his departure on February 28th, 2017.

* The inception date of the Chester High Conviction Fund was April 26th, 2017, hence FY17 reflects 8 months of SGH Australia Plus and 2 months of the CHCF.

We note this is a statement of fact of the performance achieved by the fund during the time which Rob Tucker was the sole Portfolio Manager making active decisions on the SGH Australia Plus portfolio. We note performance is the record of the firm not the individual however past performance has been constructed from publicly available unit price data. Past performance is not necessarily indicative of future performance and should not be relied upon in making investment decisions.

High Conviction Strategy - accumulated performance



Note this graph is representative only of the combination of the same Portfolio Manager running the same strategy, and would only represent actual returns for unit holders that invested money at inception of SGH Australia Plus, withdrew those funds at the end of February 2017 and then invested all those initial funds again at inception of the Chester High Conviction Fund in April 2017. Note, this depicts returns after fees.

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