OC Dynamic Equity Fund
Monthly Fund Update

31 August 2015

FUNDS MANAGEMENT

OC Dynamic Equity Fund

Global equity markets endured a volatile August driven largely by fears around the slowing growth trajectory of Australia's biggest trading partner, China, and concerns around the timing of interest rate rises in the United States. Against this backdrop, the OC Premium Small Companies Fund enjoyed a relatively strong reporting season during which most of our holdings released results in line or ahead of market expectations.

The Fund finished August up 0.5%, well ahead of the Small Ordinaries Accumulation Index and the Small Industrials Accumulation Index which were down 4.9% and 4.3% respectively. The Fund has returned 22.3% p.a. for the past three years, significantly ahead of both indices which were up 0.4% p.a. and 10.1% p.a., respectively, over the same time period.

We have written in the past about our positive view on the outdoor advertising space and **APN Outdoor Group (APO)** (+19.4%), **QMS Media Limited (QMS)** (+7.1%) and **Ooh!Media Limited (OML)** (+6.5%) all delivered excellent results which helped to reinforce our investment thesis. All three companies are benefiting from dual tailwinds, namely an increasing audience driven by a rising population that is increasingly 'out and about' (while competing advertising mediums such as television and print face structural decline) and a strong revenue and margin uplift that comes from converting static billboards to digital billboards. Both APO and OML materially upgraded their profit forecasts for CY15 and QMS reported a solid inaugural result as a listed company. We have met with the management of all three companies in recent weeks and believe they will continue to re-rate over the coming 12 months.

Executive serviced and virtual office provider, **Servcorp (SRV)** (+11.9%), delivered an excellent FY15 result which highlighted the operating leverage in the business model with revenue up 15%, NPAT up 26% and operating cash flow up 49%. SRV continues to grow strongly in both its Europe & Middle Eastern division and its North Asian division, while its US division is on track to become profitable in the current financial year. We are forecasting continued earnings momentum in FY16 (company guidance is for at least 17% NPBT growth) as recently added floor capacity continues to mature and new leases begin to contribute to profitability. The falling Australian dollar will continue to provide a tailwind for earnings translation and the balance sheet is 'net cash' which will provide a buffer should global growth stagnate.

The Fund exited **Iress (IRE)** (-9.6%) following its half-year result after management guided for earnings growth in CY15 towards the bottom end of the 3-5% prior guidance range, despite currency tailwinds. Since IRE provided its original guidance in February 2015, the AUD/GBP has fallen 8% providing a natural tailwind for earnings. The H1 FY15 result saw a declining contribution from a number of key areas of the business including:

- Australia, where the Financial Markets division was impacted by stockbroker BBY going into administration
- Canada, which was impacted by an increase in costs, and
- The UK, where the UK Enterprise division declined due to a change in the revenue model as well as increases in product and business investment.

While we continue to believe IRE has a strong business model, we exited the stock on valuation grounds given it looks expensive in light of the deterioration in the earnings outlook.

M2 Telecommunications (MTU) delivered a result which was modestly ahead of consensus expectations and the stock was surprisingly sold down 17.0% during the month. Pleasingly, organic growth remains solid, operating cash conversion is strong and the balance sheet remains well positioned at about 2x

OC Performance* (Net of Fees)	1 Mth	3 Mths	6 Mths	1 Yr	3 Yrs (p.a)	5 Yrs (p.a)	Since Incep (p.a)+
OC Dynamic Equity Fund	0.5%	**2.2%**	5.2%	11.5%	22.3%	17.3%	12.9%
S&P/ASX Small Ords Accum	-4.9%	-10.9%	-9.1%	-9.6%	0.4%	-0.7%	4.5%
Added Value	**5.4%**	**13.1%**	**14.3%**	**21.1%**	**21.9%**	**18.0%**	**8.4%**
S&P/ASX Small Ind Accum	-4.3%	-7.8%	-6.1%	-1.5%	10.1%	8.2%	5.5%
Added Value	**4.8%**	**10.0%**	**11.3%**	**13.0%**	**12.2%**	**9.1%**	**7.4%**

+Fund Inception Date: OC Dynamic Equity Fund 20/12/2000 net debt/EBITDA. The MTU board guided to 30-35% reported profit growth in FY16 driven by continued organic growth and a full-year contribution from recent CallPlus acquisition in NZ. There is no doubt some small-cap managers have reduced their positions in MTU during August in anticipation the company would exit the Small Cap Index and be elevated to the S&P/ ASX 100 Index. Although this did not eventuate, it remains a possible candidate for promotion at the next index rebalance. We believe MTU looks inexpensive (trading on 12.8x FY16 earnings) and we remain confident the high quality management team will continue to deliver strong results for shareholders.

1-Page Limited (1PG) was a stand-out performer in August, finishing the month up 66.7%. 1PG provides a cloud-based human resources software as a services (SaaS) platform to global corporates and has grown its client base substantially since its launch around 12 months ago. While we believe 1PG will continue to deliver against key milestones over the coming months, we exited the balance of our position during the month as the stock continued to push through new highs. We found it hard to resist taking profits in this holding given its share price had doubled in a matter of months and management still has much work to do to justify its present valuation. We will continue to follow 1PG over the coming months, indeed we are meeting with management this week, with a view to re-establishing a position should a consolidation in the share price allow.

Outlook

The Australian equity market pulled back sharply in August as a confluence of global and domestic events sapped investor risk appetite and ignited fears that the domestic economy is slowing further. The catalyst for the market pullback centred on concerns emanating out of China where a raft of softer economic data points foreshadowed a sharp retreat in local equity markets and simultaneously the Beijing central government moved to devalue the Yuan; these events taken together spooked global markets.

As many investors know, Australia, being a commodity country, is particularly susceptible to a slowing Chinese economy given we export large quantities of our coal and iron ore to China. In recent years, the Chinese economy has been rebalancing away from a production-led economy (which is commodity intensive) to a consumption-based economy, and this transition has not been smooth. From an Australian perspective, slowing Chinese growth continues to weigh heavily on commodity prices and as capital expenditure from the mining boom continues to taper off, the east coast economy has not picked up the slack, despite the RBA cash rate sitting at a record low of 2.00%.

In terms of our portfolio positioning, we continue to largely avoid stocks exposed to the commodity cycle and have limited exposure to domestic cyclical stocks that rely on a robust Australian economy to generate earnings growth. The August reporting season saw continued underperformance from these types of companies and regular readers of our investment updates will know we have been cautious on them for some time.

Results and company commentary from the August reporting season and recent weak economic data, including the weak domestic GDP print of 0.2% for the June quarter, have served to strengthen our conviction in our preferred investment thematics. These include:

- Stocks with structural tailwinds underpinning their earnings growth (e.g. **APN Outdoor**, **Ooh!Media**, **Ozforex**, **REA Group**);
- Quality companies that can grow their earnings outside of the economic cycle (e.g. **Fisher & Paykel Healthcare**, **iSentia**, **Healthscope**);
- Companies with solid exposure to the US economy which continues to grow steadily (e.g. **Aconex**, **Ardent Leisure**, **Hansen**);
- Stocks with currency tailwinds given the continued fall in the AUD against most of our trading partners (e.g. **Servcorp**, **BT Investment Management**, **Henderson Group**).

The beauty of investing in small- to mid-cap companies is that, despite the structural and macro issues facing the Australian economy, it is often possible to find sectors and stocks that are performing well. The investment team has met with most of our investment holdings over the past month, as well as some of their competitors and many potential portfolio additions. Despite the near-term economic headwinds, we remain confident that the portfolio is well positioned and that we will continue to deliver strong long-term investment performance for our investors.

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* Past performance is not a reliable indicator of future performance. The Total Returns of the OC Dynamic Equity Fund over specified periods are shown in the above table. This table contains information regarding Total Returns to 31 August 2015. Total Returns are calculated after taking into account performance fees. Where OC Funds generates a return on the OC Dynamic Equity Fund over and above the performance hurdle of 15% in any financial year, a performance fee of 20.5% of all profits above this level is charged to the Funds directly. The Total Return performance figures quoted are historical, calculated using end of month mid prices and do not allow the effects of income tax or inflation.

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