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Dear Fellow Investors,

Welcome to the **April 2018 Ophir Letter to Investors** – thank you for investing alongside us for the long term.

### Month in Review

The Australian equity market proved the comfortable outperformer versus regional and global counterparts this month, with the ASX 200 surging +3.9% for April (shrugging off three previous months of negative absolute returns) and outperforming the MSCI World index by some 3.1%. While gains were broad-based (with all 11 industry GIC sectors delivering a positive return for the month), the bulk of returns this month were derived across the materials and energy sectors, driven by a broadly improving global commodity complex and ongoing corporate activity in the space. While still generating an overall positive return, Australian smaller cap equities were unable to keep pace with their larger cap counterparts, **the ASX Small Ordinaries finishing the month +2.8%** with the resources sector again providing the bulk of the gains. The ASX Small Resources finished the month +6.9%, outperforming the Small Industrials by 5.4%

|                                       | 1 month       | 6 Months    | 1 Year       | 5 year p.a.       | Inception p.a.    |
|---------------------------------------|---------------|-------------|--------------|-------------------|-------------------|
| Ophir Opportunities Fund <sup>^</sup> | <b>(1.5%)</b> | <b>8.3%</b> | <b>39.0%</b> | <b>29.5% p.a.</b> | <b>36.3% p.a.</b> |
| Benchmark*                            | 2.8%          | 7.1%        | 18.4%        | 8.0% p.a.         | 8.1% p.a.         |
| Value Add (Gross)                     | (4.3%)        | 1.2%        | 20.6%        | 21.5% p.a.        | 28.3% p.a.        |
| Fund Return (Net)                     | (1.6%)        | 7.6%        | 37.2%        | 23.2% p.a.        | 28.6% p.a.        |

\* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

|   | 1 month     | 6 Months     | 1 Year       | 2 Year p.a.       | Inception p.a.    |
|---|-------------|--------------|--------------|-------------------|-------------------|
| Ophir High Conviction Fund <sup>^</sup> | <b>0.8%</b> | <b>13.4%</b> | <b>34.3%</b> | <b>21.3% p.a.</b> | <b>31.2% p.a.</b> |
| Benchmark*                              | 2.8%        | 6.7%         | 16.6%        | 5.2% p.a.         | 14.7% p.a.        |
| Value Add (Gross)                       | (2.0%)      | 6.7%         | 17.8%        | 16.1% p.a.        | 16.5% p.a.        |
| Fund Return (Net)                       | 1.1%        | 11.6%        | 31.2%        | 19.0% p.a.        | 25.4% p.a.        |

\* 50% S&P/ASX Small Ordinaries Accumulation Index (XSOAI), 50% S&P/ASX Midcap 50 Accumulation Index (XMDAI)

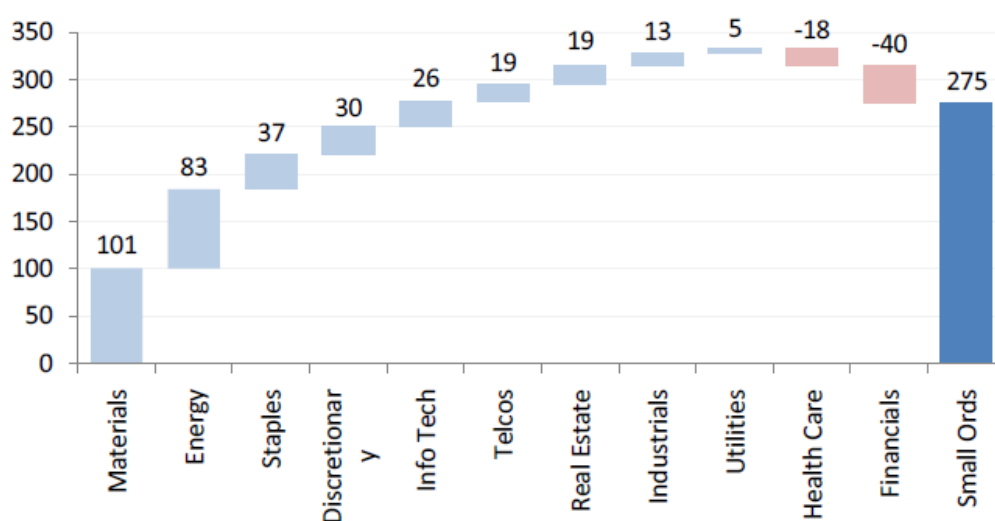
In investing (as in life) there are no certainties – however one can provide a fairly fail-safe guarantee that there will be occasions when fund returns for the month fall behind the underlying index. This month has proven to be one of those occasions, with both the Opportunities Fund (-1.5%) and High Conviction Fund (+0.8%) underperforming their respective performance benchmarks through April. While we tend not to place a large amount of focus on the vagaries of month-to-month reporting, we do look to ensure we have a full understanding of any drivers of performance drag (however short term they may be) in order to understand whether those factors are explainable and short-term, or instead the beginnings of something more systemic.

**On analysis of the key drivers this month, we remain wholly unconcerned.** With an investment process and style that tends to lead us away from investments within more traditional mineral extraction and resources companies, it is not wholly unsurprising to see the portfolios experience some level of relative underperformance through periods when those sectors have lead the market. Interestingly, the last occasion where either Fund generated a return below the index was

November 2017 – a month where the Small Resources delivered an +8.1% return. Pleasingly, prior to November, we have to go back to April 2017 for the last month the Opportunities Fund underperformed the index, while the High Conviction Fund last underperformed its benchmark in February 2017.

An improving commodities complex and generally more buoyant operating environment for the businesses that service the space is a trend we expect to continue and one we have flagged in these Letters for some time.<sup>1</sup> A resurgent resources sector is typical of later-cycle economic recoveries in as end-user demand begins to outstrip supply and the resultant adjustment in prices spur a new wave of exploration, production and corporate M&A activity. April has seen this thematic continue, with the proposed \$13.5bn acquisition of **Santos (STO)** by US-based Harbour Energy, alongside **Mineral Resources’ (MIN)** \$280m acquisition of **Atlas Iron (AGO)** and a \$290m bid for African mineral sands hopeful **Mineral Deposits (MDL)** from French mining major ERAMET.

**ASX Small Ordinaries – Sector Contribution to Return for April (Bps)**



Source: Morgan Stanley Research

We remain sufficiently leveraged to the sector through the ownership of a number of industrial businesses operating within the mining services and contracting space, many of which are continuing to report improving tender pipelines and a need to increase headcount to meet future expected demand. While undoubtedly there will be months, such as April, when the more traditional (and more leveraged) single-commodity mining businesses see aggressive market support as analysts re-adjust their commodity forecast assumptions to the prevailing spot prices, **we remain very comfortable with our current positioning in the space** – particularly given the valuation support that pockets of the sector continue to offer amidst a steadily improving earnings profile.

Outside of an underweight to the more traditional mineral-extraction businesses, both portfolios this month experienced some weakness from a small handful of positions that experienced some profit taking following their respective company updates. For the Opportunities Fund, this included positions in **Redbubble (RBL)**, **Experience Co (EXP)** and **Pushpay (PPH)** and for the High Conviction Fund, positions in **Afterpay Touch (APT)** and **Pushpay (PPH)**. We’ll discuss a couple of these updates below.

Whilst the share prices of these businesses have detracted somewhat as a result, in each case we feel the underlying investment proposition remains compelling and the growth runway ahead of the business continues to be similarly attractive. In most cases, the subsequent sell-off has more than

<sup>1</sup> See Ophir Letter to Investors – November 2017 (available on <http://www.ophiram.com.au/insights-and-media>)

likely been a function of the broader share price strength the business has enjoyed in recent months, rather than reflective of any structural longer term concerns emerging within each business.

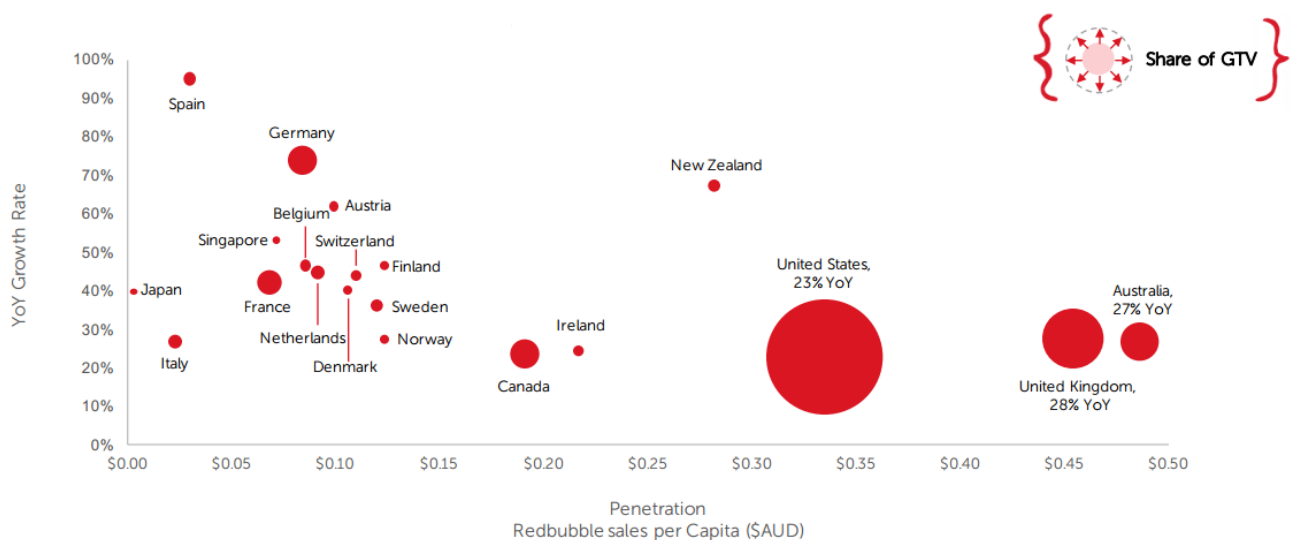
**Earnings momentum remains a pervasive driver of returns across the smaller cap space at present** and any stalling in that momentum – however short term in nature that may be – has in many cases driven fairly abrupt turnarounds in the near-term direction of underlying share prices. That, to us, continues to provide opportunities to add or increase positions within the portfolios that are momentarily priced on a short-term event that ultimately bears little impact on the ability of the business to continue to grow longer term.

**Redbubble (RBL)**, for example, is an exciting little e-commerce business that typifies the global opportunity set now available to innovative, asset-light Australian businesses in an increasingly connected global market place. Entire business models designed to leverage off the increased connectivity of people and markets have emerged in recent years that simply would not have been possible ten to fifteen years prior. Perhaps of most excitement to Australian investors is that this ever-increasing connection of global markets and prospects now enables the same opportunities for a business in Melbourne or Brisbane to aggressively enter and dominate a global market as it does one based in London or New York.

Starting in 2006, Redbubble provides a sound example of this – the business operates an open online marketplace that facilitates independent artists worldwide to advertise and submit their individual designs for consumers to peruse and purchase and then have printed on any variety of surface – be it on a t-shirt, a canvas wall print, an iPhone case or a coffee mug. The business makes its money by simply taking a percentage commission on each transaction between consumer and artist and, therefore, devotes the bulk of its strategic focus on increasing the number of artists and prints that are available on the site and the number of consumers engaging and transacting with them.

In an era where the individuality or uniqueness of design (particularly amongst the millennial cohort) is often coveted more than a recognisable consumer brand, the business has experienced fairly incredible growth. From early beginnings, the business now provides an outlet for some 260,000 different artists servicing in excess of ~3m unique customers across the globe. At the company's most recent quarterly update, the business highlighted the Redbubble website had received 65.3m individual visits to the website over the three-month period alone, representing growth of +36% on the prior period. Gross transaction value (a measure of the transactions completed between artists and consumers) completed over the quarter totalled \$48.9m (or just shy of \$200m annualised), representing growth of +28% on the prior period.

### Year-on-Year Product Sales Growth by Region CY2017

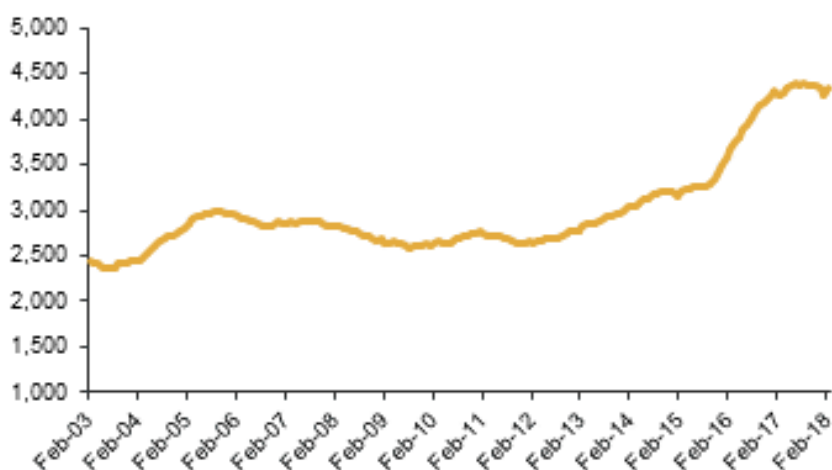


This is a business now in rapid growth phase, leveraging off their ten years of platform innovation and brand existence. With a significant first mover advantage and enormously diverse (and hard to replicate) range of artist content available, we expect the business remains well placed to experience material growth from here. Growth, however, is never linear and there will inevitably be occasions where an expected metric (be it in top line sales, customer conversions, web visits, artists numbers etc etc) invariably misses a stated consensus expectation causing some readjustment of near-term forecasts. Such was the case in the third quarter release this month, where marketing spend crept higher than consensus analysts had initially expected and the stock was subsequently sold off as a result.

We're not too concerned and are happy to look through the noise of quarter-to-quarter releases given we continue to view the (arguably more attractive) medium to long term thematic remains attractive. We recently spent time with an unlisted US competitor in Los Angeles that provided some encouraging insights on the industry structure, including confirmation of the view that the competitive landscape continues to behave rationally while opportunities for continued growth remain widespread.

Another victim of a softer quarter this month was adventure tourism business **Experience Co (EXP)**, a company that began in 1999 as a single-site tandem skydiving operation in North Wollongong to become a \$320m market cap business operating 18 skydiving 'dropzones', in addition to various adjacent businesses across hot air ballooning, white water rafting and Great Barrier Reef experiences. With a great many independent tour and adventure/ experience operators primarily operating as family-run or cottage businesses, the management team behind EXP have done a formidable job of consolidating a number of these operators onto their own platform, therein allowing for the benefits of shared booking platforms, marketing initiatives and cross-sell opportunities to drive customer bookings.

#### Inbound Holiday Arrivals to Australia – Moving Annual Totals ('000's)



Source: Ord Minnett Research

As the dominant player within an industry that is seeing strong organic growth from both elevated inbound tourism numbers and the growing preference for more experience-based travel activities, the business has grown EBITDA (organically and by acquisition) from \$5.9m at the time of its listing in 2015 to an expected ~\$30m for the FY18. Unfortunately, as a predominantly *outdoor* tourism operator, the business is heavily reliant on favourable weather conditions (given the bulk of adventure activities are unable to be completed in wet weather, with full refunds provided in most cases). With approximately ~50% of annualised group earnings being generated out of the Cairns and Port Douglas region at present, the business is highly sensitive to North Queensland weather patterns and was subsequently impacted from highly unseasonal rainfall through March and April.

Weather, obviously, is a difficult variable to price and the impact from such an outcome can generally only be measured after the event. In this case, the business has been forced to amend their original full year earnings guidance of \$35-37m back to to \$30-31m, reflecting not only the length of time that a number of operations were at a standstill, but also the fact that March-April is peak season for the business. In terms of understanding the risk of a future occurrence, the rainfall experienced through March and April was certainly an outlier – Cairns, for example, received more than 34% of its entire annual average rainfall in March alone, while Port Douglas received almost half.

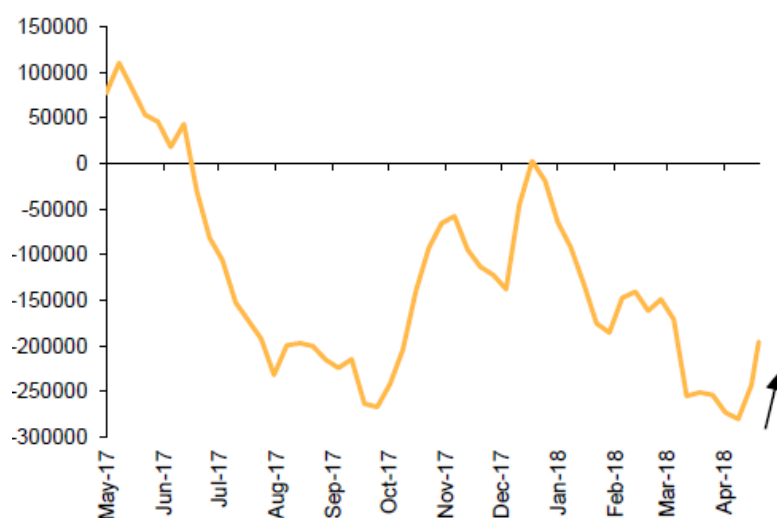
While the share price of the business has subsequently de-rated in the short term, we continue to be attracted to the business operations, excellent management team (who, incidentally, speak for more than a third of the share register) and growth runway ahead of it. An outlier weather event will no doubt have been a difficult pill for the management team to swallow, particularly given they have confirmed the business had been on track to meet their initial earnings guidance, however we remain happy to look through the shorter term impact to focus on the more generous opportunities still available for the business further out.

**Turning to broader capital markets**, the bulk of global investor interest this month has focused on the US corporate earnings season which, by and large, has produced some fairly stellar results at the bottom line. As at the time of writing, 402 companies within the S&P 500 had reported their 1Q18 numbers, with 77% beating consensus earnings per share (EPS) estimates, for an average +25% growth in earnings across the index (its strongest growth in over seven years). **While a pleasing result for Corporate America, the resultant equity market reaction has been somewhat muted**, given the benefits of company tax cuts and the broadly stronger domestic economy have arguably already been well baked-in to equity market valuations. Better-than-expected results from tech titans Facebook and Amazon, however, saw aggressive re-ratings in both businesses' share prices and subsequently sparked a turnaround in fortunes for the tech space following a brief sell-off at the beginning of the month.

In the era of mega-cap tech businesses, we tend to all-too-easily throw the word 'billions' around without taking some pause to consider the size in which these companies have continued to grow and the market capitalisation they now command. For the 1Q18 just reported, Facebook reported revenue growth of +49%, Amazon +43% and Google +29% - growth rates that are all the more impressive given the revenue base from which they are growing already sit in the thousands of millions. **As at the end of March 2018, the combined market cap of those three businesses alone sits at A\$2.6 trillion.** For some perspective, the All Ordinaries Index (representing Australia's 500 largest listed companies) currently sits at A\$1.8 trillion.

While an improving US economy and the expected benefits from US corporate tax cuts have been largely expected, **a somewhat unexpected resurgence of the US dollar in recent weeks has come as somewhat of a surprise.** On a trade-weighted basis, the US dollar is now +4.5% from mid-February, while the Australian Dollar/US Dollar cross has fallen more than -7%. This will continue to prove interesting, given position reporting estimates supplied by the Commodity Futures Trading Commission in mid-April indicated the rally in the US dollar was occurring at the same time as hedge funds and speculators had amassed their largest net short position in five years. Unsurprisingly, at the time of writing, this positioning was beginning to unwind somewhat rapidly causing some instability across emerging market currencies and equities as carry trade positions are closed out.

### US Dollar Net Non-Commercial Futures



Source: Macquarie Research, Bloomberg

With the Australian dollar reversing from \$0.81 at the beginning of the year to now hovering around \$0.75, it has been unsurprising to see renewed interest across the Australian market towards businesses earning revenues in US dollars. With fairly limited economic growth on offer domestically, we have for some time maintained a fairly material tilt across both Ophir portfolios towards companies with growth opportunities offshore and we are expecting to benefit somewhat from the currency tailwinds on offer as offshore profits from these businesses are repatriated to Australian dollars.

Given the size of the moves across a number of currency baskets, this will be a thematic to watch in the coming months as companies approach the ‘confession’ season ahead of the announcement of full year financial results in August. **The month of May has a tendency to produce an elevated number of earnings downgrades** (on Goldman Sachs numbers, ~12% of industrial businesses within the ASX 200 have reported EPS downgrades greater than 5% since May 2007) and currency will likely emerge as a factor in some cases. Similarly, we would expect sell-side estimates to begin to adjust as analysts begin to update their numbers ahead of full-year results and, in doing so, update their currency assumptions from the previous reporting period in February. Dependent on business models and/ or industry sectors, the impact from these currency translations will work both ways.

For businesses with global operations that earn British Pounds or the Chinese Renminbi, for example, the currency translation effect will likely see positive near-term earnings revisions given current spot rates sit more than 7% above where they were at the time of first-half reporting. On the other hand, businesses that purchase goods offshore to then sell to domestic consumers or businesses in Australian dollars will likely see some negative revision as input costs begin to crimp margins – **domestic retailers, for example, would be one of the more obviously exposed sectors coming into financial year-end:**

### AUD Cross-Rate Moves from 1H FY18

| CURRENCY | PRIOR REPORTING PERIOD AVERAGE | SPOT AT 30 APR 2018 | CHANGE |
|----------|--------------------------------|---------------------|--------|
| USD      | 0.7794                         | 0.753               | -3.39% |
| EURO     | 0.6623                         | 0.6234              | -5.87% |
| GBP      | 0.5911                         | 0.5471              | -7.44% |
| YUAN     | 5.177                          | 4.7755              | -7.76% |
| NZD      | 1.091                          | 1.0704              | -1.89% |

Domestically, the explosive revelations uncovered as part of the **Royal Commission into Misconduct in the Banking and Financial Services Industry** dominated a large bulk of investor interest toward the end of the month, with the second round of hearings exposing a number of significant failings across the wealth management industry as a whole. Given the depth of institutionalised shortcomings reported across a number of larger financial services businesses, we are expecting the prospect of regulatory risk to remain a cloud across the sector for the near term (despite the hearings already resulting in a number of high profile CEO and Board resignations). With the rose-coloured glasses firmly on, we are hopeful that the enquiry will ultimately result in a better deal for Australian superannuants and consumers that have entrusted others with the careful management of their life savings.

Given we have been fortunate enough to be afforded an opportunity to attend the **Berkshire Hathaway Annual General Meeting** in Omaha, Nebraska this month, we have been reminded of a testimony that Chairman and CEO Warren Buffett provided to a Subcommittee of the U.S. House of Representatives in 1991 following the uncovering of a bond-rigging scandal at investment bank Salomon Brothers. Buffett, who had been the largest investor in the business at the time, took the reins of the business as Chairman and Chief Executive (for a nominal annual salary of \$1) to navigate the restructure and rebuild of the damaged brand.

Buffett's submission to the US House of Representatives may provide some useful motivation for the senior management teams now charged with the responsibility of restoring both the internal culture and consumer's trust within their own respective corporate identities, a selection of which we have provided below:

*“Mr. Chairman, I thank you for the opportunity to appear before this subcommittee. I would like to start by apologizing for the acts that have brought us here. The nation has a right to expect its rules and laws to be obeyed. And at Salomon, certainly these were broken. Almost all of Salomon's 8,000 employees regret this as deeply as I do. And I apologize on their behalf as well as mine.*

*“The submission to this subcommittee details actions that I believe will make Salomon the leader within the financial services industry in controls and compliance procedures. But in the end, the spirit about compliance is as important or more so than words about compliance. I want the right words and I want the full range of internal controls. But I also have asked every Salomon employee to be his or her own compliance officer.*

*“After they first obey all rules, I then want employees to ask themselves whether they are willing to have any contemplated act appear the next day on the front page of their local paper, to be read by their spouses, children, and friends, with the reporting done by an informed and critical reporter.*

*“If they follow this test, they need not fear my other message to them: **Lose money for the firm, and I will be understanding; lose a shred of reputation for the firm, and I will be ruthless.**”*

- Warren Buffett, Testimony before the Subcommittee of Conduct at Salmon Brothers, September 4<sup>th</sup>, 1991.

Given we are travelling in the US at present, we will delay our regular **‘Strategy Notes’** commentary to a little later in the month. We look forward to also sharing some updates from our travels in Omaha, alongside an update on a number of US-facing businesses that we have been fortunate enough to visit on this trip.

### **A Word on Cash Distributions and Distribution Reinvestment Plans.**

As we enter the final quarter of the Financial Year, we would encourage investors – particularly those that have joined the Funds recently – to ensure they are aware of the distribution preference they have opted for (cash or reinvestment of distribution) at the time of their application.

Each investor will have their own preference, dependent on their requirements for cash income or a desire to compound their invested capital over time. It will perhaps be of no surprise that we favour the latter, given the benefits of the compounded return have begun to demonstrate a fairly material effect for investors that have supported us from inception.

For example, an investor that invested \$100,000 of capital into the Ophir Opportunities Fund at inception in 2012:

- if opting for cash distribution would have an after-fee total return (capital appreciation of units plus the cash distributions returned) of \$389,275. This equates to a gross profit of \$289,275 on their original investment;
- if opting for reinvestment of units would have an after-fee total return of \$430,200, or gross profit of \$330,200 on their original investment. The \$40,925 difference in gross profit between the investor that has opted for cash versus reinvestment represents ~41% of the total amount that had been originally invested at inception.

**As always, thank you for entrusting your capital with us.**

Kindest regards,

Andrew Mitchell & Steven Ng

Co-Founders & Portfolio Managers

Ophir Asset Management



# The Ophir Opportunities Fund

## Growth of A\$100,000 (pre all fees) since Inception



\* Chart represents gross value of \$100,000 invested since inception and assumes dividends reinvested.  
Please note past performance is not a reliable indicator of future performance.

The **Ophir Opportunities Fund** returned -1.5% for the month, underperforming the benchmark by 4.3%. Since inception, the Fund has returned +492.9%, outperforming the benchmark by 436.8%.

|   | 1 Month | 1 Year | 5 Year (p.a.) | Inception (p.a.) | Since Inception |
|---|---------|--------|---------------|------------------|-----------------|
| <b>Ophir Opportunities Fund (Gross)</b> | (1.5%)  | 39.0%  | 29.5%p.a.     | 36.3%p.a.        | 492.9%          |
| Benchmark*                              | 2.8%    | 18.4%  | 8.0%p.a.      | 8.1%p.a.         | 56.1%           |
| Gross Value Add                         | (4.3%)  | 20.6%  | 21.5%p.a.     | 28.3%p.a.        | 436.8%          |
| Net Fund Return                         | (1.6%)  | 37.2%  | 23.2%p.a.     | 28.6%p.a.        | 323.2%          |

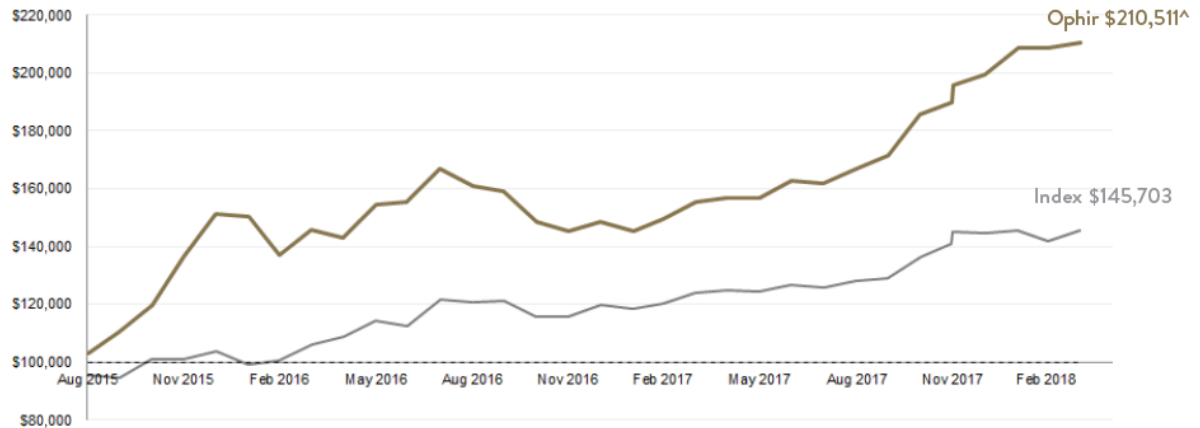
\* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

|   | Buy Price | Mid Price | Exit Price |
|---|-----------|-----------|------------|
| <b>April 2018 Unit Price – Opportunities Fund</b> | 2.7750    | 2.7653    | 2.7556     |

Key contributors to the Opportunities Fund performance this month included **Adairs Limited (ADH)**, **APN Outdoor Group (APO)** and **Zip Co Ltd (Z1P)**. Key detractors included **Experience Co Ltd (EXP)**, **Redbubble Limited (RBL)** and **Pushpay Holdings Ltd (PPH)**.

# The Ophir High Conviction Fund

## Growth of A\$100,000 (pre all fees) since Inception



\* Chart represents gross value of \$100,000 invested since inception and assumes dividends reinvested. Please note past performance is not a reliable indicator of future performance.

The **Ophir High Conviction Fund** returned +0.8% for the month, underperforming the benchmark by 2.0%. Since inception, the Fund has returned +110.5%, outperforming the benchmark by 64.8%.

|   | 1 Month | 1 Year | 2 Year(p.a.) | Inception (p.a.) | Since Inception |
|---|---------|--------|--------------|------------------|-----------------|
| <b>Ophir High Conviction Fund (Gross)</b> | 0.8%    | 34.3%  | 21.3%p.a.    | 31.2%p.a.        | 110.5%          |
| Benchmark*                                | 2.8%    | 16.6%  | 5.2%p.a.     | 14.7%p.a.        | 45.7%           |
| Gross Value Add                           | (2.0%)  | 17.8%  | 16.1%p.a.    | 16.5%p.a.        | 64.8%           |
| Net Fund Return                           | 1.1%    | 31.2%  | 19.0%p.a.    | 25.4%p.a.        | 85.7%           |

\* 50% S&P/ASX Small Ordinaries Accumulation Index (XSOAI), 50% S&P/ASX Midcap 50 Accumulation Index (XMDAI)

|  | Buy Price | Mid Price | Exit Price |
|--|-----------|-----------|------------|
| <b>30 April 2018 Unit Price – High Conviction Fund</b> | 1.8485    | 1.8429    | 1.8374     |

Key contributors to the High Conviction Fund performance this month included **NextDC Limited (NXT)**, **Speedcast International Limited (SDA)** and **Xero Ltd (XRO)**. Key detractors included **Afterpay Touch (APT)**, **Pushpay Holdings Ltd (PPH)** and **SG Fleet Group Ltd (SGF)**

*This document is issued by Ophir Asset Management (AFSL 420 082) in relation to the Ophir Opportunities Fund & the Ophir High Conviction Fund (the Funds) and is intended for wholesale investors only. The information provided in this document is general information only and does not constitute investment or other advice. The content of this document does not constitute an offer or solicitation to subscribe for units in the Funds. Ophir Asset Management accepts no liability for any inaccurate, incomplete or omitted information of any kind or any losses caused by using this information. Any investment decision in connection with the Funds should only be made based on the information contained in the Information Memorandum and/or Product Disclosure Statements.*