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Dear Fellow Investors,

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

Month in Review

August 2018 arrived with the usual flurry of activity that accompanies any regular ASX reporting period, albeit this month saw a number of share price performances that seemingly defied gravity as high-growth and high-quality businesses again aggressively swung into favour. While the month saw a relatively high level of volatility at the individual stock level, overall market returns for August ultimately ended in-line with historical seasonal trends. Even the added drama of a prime ministerial dismissal did little to slow the forward momentum of the market, with the ASX 200 finishing August +1.4% on a total return basis (helped by a +0.8% contribution from dividends paid through the month). **Mid-cap companies attracted the greatest degree of investor support, with the ASX Midcap 50 Index rising +2.94% for the month** (aided significantly by the +50% share price appreciation in index-heavyweight TPG Telecom following its announced merger with competitor Vodafone Hutchison). Small caps were not far behind the pace, however, with **the ASX Small Ordinaries closing out the August reporting period +2.49%**, inclusive of dividends paid.

	1 month	6 Months	FYTD	5 year p.a.	Inception p.a.
Ophir Opportunities Fund [^]	3.7%	7.5%	5.4%	28.0% p.a.	36.1% p.a.
Benchmark*	2.5%	6.7%	1.5%	9.2% p.a.	8.7% p.a.
Value Add (Gross)	1.2%	0.7%	3.9%	18.8% p.a.	27.5% p.a.
Fund Return (Net)	3.6%	6.8%	5.2%	22.5% p.a.	28.7% p.a.

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

	1 month	6 Months	FYTD	2 Year p.a.	Inception p.a.
Ophir High Conviction Fund [^]	5.1%	13.3%	6.2%	21.2% p.a.	32.3% p.a.
Benchmark*	2.7%	6.7%	2.9%	4.2% p.a.	15.4% p.a.
Value Add (Gross)	2.3%	6.6%	3.3%	17.0% p.a.	16.9% p.a.
Fund Return (Net)	4.5%	11.5%	5.4%	18.4% p.a.	26.5% p.a.

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

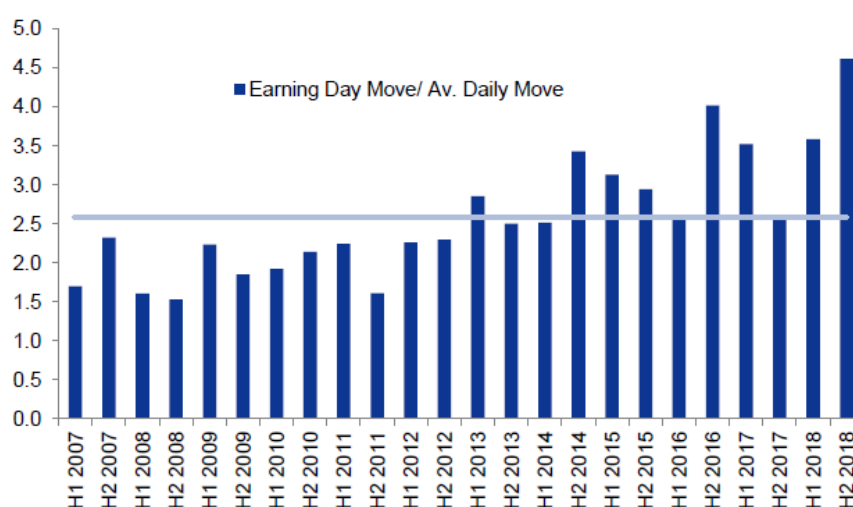
While equity market returns proved favourable for local investors this month, the volatility experienced across currency markets through August will have delivered offshore investors with a less fruitful experience. In the face of another weak performance from the Australian dollar (falling -3.2% over the month against the US Dollar), the ASX 200 return, measured in USD terms, drifted into negative territory for the month, falling -1.8%.

Pleasingly, both Ophir Funds navigated the ASX reporting period well, with **the Ophir Opportunities Fund generating +3.6% for the month after fees, while the Ophir High Conviction Fund delivered a net return of +4.5%.**

While August certainly proved to be a busy period for the investment team (including 41 one-on-one company management meetings held at Ophir and an additional 28 meetings attended in a group environment), we're certainly pleased with the net result, particularly given the FY18 results season was not without its challenges.

Indeed, while the underlying index performances reported at end of month might suggest a fairly benign reporting period, **overall individual stock volatility over the month was significantly higher than previous reporting seasons** and inevitably required some careful navigation. On Goldman Sachs estimates, for example, the average share price volatility (or dispersion of returns) experienced by a company on the day it reported this month was 4.6x its normal daily trading average (where historically the average increase through the day of reported lifts to ~2.5x), indicating an uplift in single stock volatility this month of some 86% on previous reporting periods.

Ratio of Share Price Moves on Results Day vs 30-Day Prior (new high)



Source: Goldman Sachs Research

Despite both portfolios delivering solid returns on aggregate for the month, there will always be room for improvement and we didn't escape the results season this month without a small number of disappointments. Satellite communications provider **Speedcast (SDA)**, for example, saw a meaningful share price decline after providing weaker than expected outlook guidance and the announcement of an acquisition that would see net debt levels lift in excess of three times the company's current earnings.

The business essentially provides satellite connectivity for isolated mine sites and marine-based commercial activities (for instance, providing WiFi-connections for cruise ships and offshore oil rigs) and, while we had already been expecting a softer FY18 result, the fairly tepid outlook and increased costs associated with the renewal of a major contract saw the share price come under pressure. While we still like the space and the opportunity ahead for the company (the current elevated oil price ultimately will see more deep water oil rigs being brought on line and requiring communication connectivity), the announced US\$135m acquisition of competitor Globecomm ultimately took the balance sheet to a level that we're broadly uncomfortable with for a cyclical business at this time of the investment cycle. We subsequently exited the position.

While we can spend an inordinate amount of time trying to understand a company's earnings trajectory, the sustainability of their competitive advantage or their ability to generate a meaningful return on capital, it is much harder to model or successfully predict the timing and/ or attractiveness of a surprise growth acquisition. We also faced a similar issue this month with our investment in packaging provider **Pact Group (PGH)**, a business that we were initially drawn to

for the opportunity ahead of management in successfully executing an asset rationalisation and optimisation program following a recent increase in their underlying cost base. While packaging businesses tend to face annual input costs that can be highly cyclical and are, admittedly, not overly high quality businesses, we purchased shares in the company given the valuation looked attractive and the runway to achieve some fairly meaningful cost reductions (and, therefore, an uplift in future earnings) looked relatively simple.

Unfortunately, while the business did provide an update on asset optimisation, the underlying details were scarce and were ultimately overshadowed by the surprising acquisition of plastic coat hanger pooling business TIC Retail Accessories for \$122m. Adding new assets typically tends to run counter to what one might expect to see from an asset rationalisation program, whilst management also outlined a need to add additional costs back into the businesses to recover some weakness in top line revenues experienced over FY18. Ultimately, with our initial investment thesis now challenged, we took the decision to exit our position and will keenly watch from the sidelines for any future updates on cost-out activities.

While both positions detracted from overall investment performance for the month, neither company occupied a significantly large position in either fund and we have been pleased that the businesses that did command larger weightings in each portfolio have performed well.

Running concentrated equity portfolio's means that we not only have to ensure that we get the directional calls right, but also must strive to ensure we have an appropriate weighting to those businesses where we have a high degree of conviction in the future share price trajectory.

In this regard, we were particularly pleased with strong earnings updates from a number of our larger portfolio weights, including solid performances from **Afterpay** (APT, +27.9%), **Webjet** (WEB, +27.3%), **Service Stream** (SSM, +13.0%) and **The A2 Milk Company** (A2M, +19.79%). In addition to these names, we discuss in more detail in this month's *Strategy Notes* three company results that we felt provided particularly pleasing updates across the funds: online auto retailer **Carsales.com** (CAR), kitchen appliance manufacturer **Breville Group** (BRG) and online lottery provider **Jumbo Industries** (JIN).

Famed US investor Stanley Druckenmiller in his interview for Jack Schwager's now seminal book *'The New Market Wizards'* (1994) provides one of the more succinct observations in regards to portfolio weightings – when reflecting on lessons learned from equally iconic investor George Soros, Stanley remarked:

“It's not whether you're right or wrong that's important, but how much money you make when you're right and how much you lose when you're wrong”¹

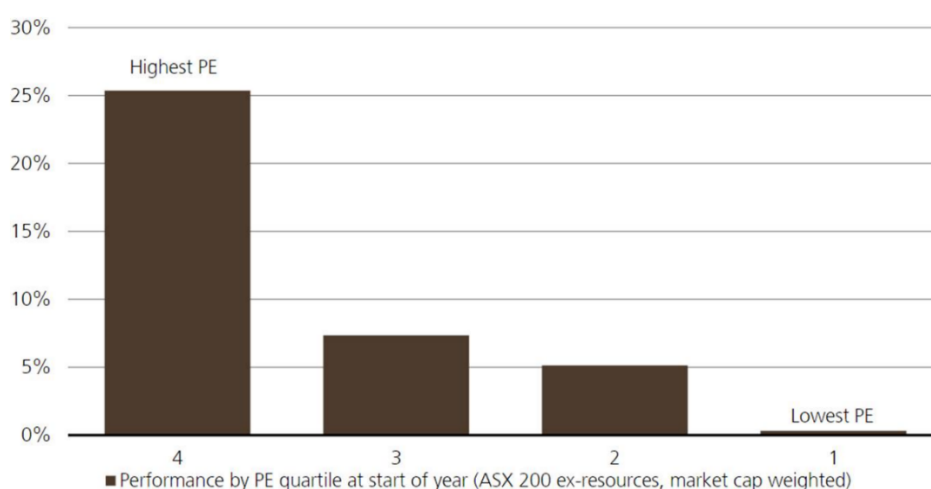
It's a lesson we hold in equally high regard and we're pleased that prudent portfolio management this month has ensured that the majority of sub-optimal outcomes experienced were broadly contained, whilst better performing companies have materially added to overall portfolio performance.

¹ Stanley Druckenmiller as quoted in *The New Market Wizards: Conversations with America's Top Traders* (1994) by Jack D. Schwager

August Reporting Season Review - The Rich Get Richer (Or, What Just Happened?)

The most obvious theme across both the smaller and larger cap ends of the market this month has been the continued outperformance (and subsequent valuation uplift) experienced by the cohort of businesses broadly falling into the 'high growth' or 'high quality' categories. In a continuation of a thematic that has remained broadly intact since early 2017, **expensive growth businesses that deliver on earnings have continued to get more expensive**, whilst those that miss expectations have quickly lost market support. Indeed, across the ASX 200 (excluding resources), the companies that entered the 2018 calendar year in the highest valuation quartile (measured by one-year forward price/earnings multiple) have outperformed their counterparts in the bottom quartile by over 25% in just eight months.

Share Price Performance by Price/Earnings Quartile – YTD

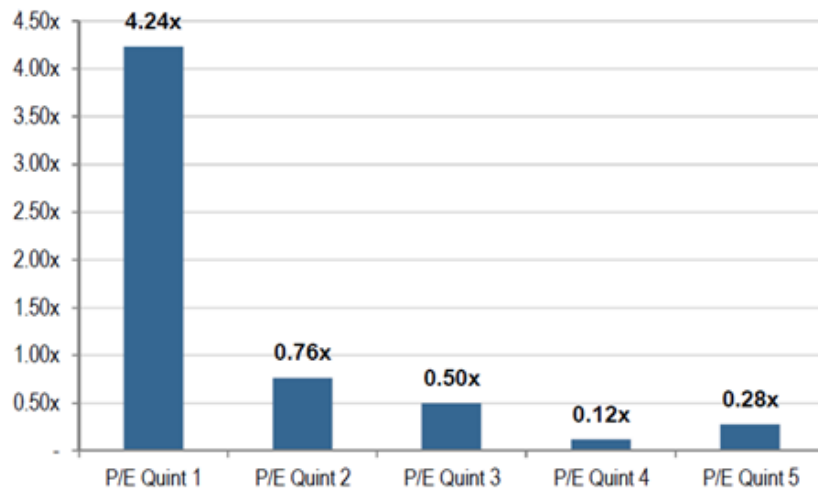


Source: Factset, UBS Investment Research

Such strong outperformance from growth businesses for the year to date inevitably led to a growing amount of market noise and commentary suggesting **a pending rotation away from defensive growth companies and back into more traditional value-type businesses**. Whilst we had cautioned in our most recent Letter to Investors in July against rotating a significant portion of capital towards the more cyclically exposed/ value-oriented companies at the current point in the cycle (you can read the full letter [here](#)), we will admit that **we were still surprised by the sheer voracity of market support that a number of higher-growth businesses received this month** – particularly following earnings updates that only marginally beat consensus.

Across the ASX 300, for example, the top 15 best performing stocks for the month enjoyed an average share price appreciation of some +17% through August, despite delivering an average earnings-per-share upgrade of just +1.5%. As a representation of the momentum towards businesses with more elevated earnings multiples this month, those companies within the top 20% most expensive in the market (again, as measured by forward PE multiple) **saw an average increase in their underlying PE multiple of 4.24 points**, while the next quintile achieved an increase of just 0.76 points.

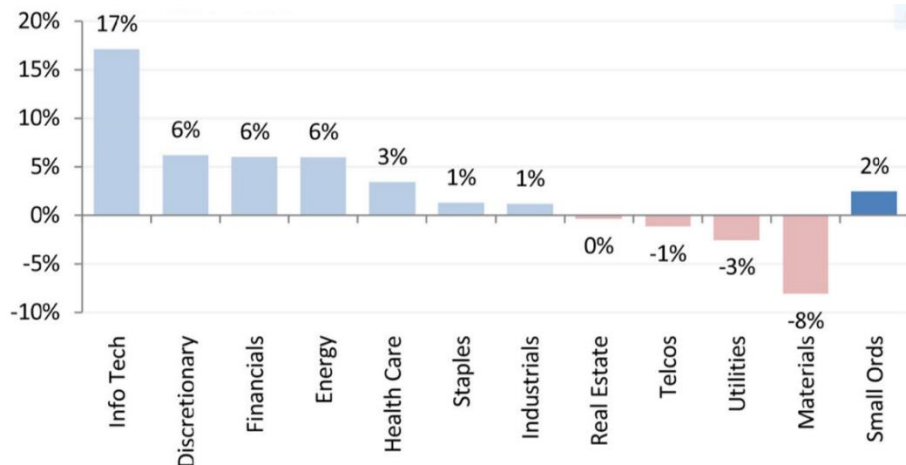
Price/Earnings Expansion by Quintile (ASX 300)



Source: JP Morgan Research

This virtual whipsaw of capital back towards higher growth / higher valuation businesses has been most evident across the more growth-heavy small and mid-cap equities space, particularly following significant contributions from companies within the emerging technology and IT sectors. While the ASX Small Ordinaries delivered a total index return of +2.49% for August, a large proportion of this return came as a result of a +17% contribution from the information technology sector alone. Indeed, just four companies - **Altium (ALU)**, **Afterpay (APT)**, **Appen (APX)** and **Wisetech (WTC)** – were ultimately responsible for 60% of the total monthly return of the entire ASX Small Ordinaries Index this month.

ASX Small Ordinaries Sector Performance – August 2018



Source: Bloomberg, Morgan Stanley Research

Historically, these kinds of aggressive moves tend to reflect shorter-term market positioning rather any significant underlying change in the fundamental outlook and we would caution against expecting future valuation uplifts in response to similar earnings outcomes. While growth businesses have delivered some outstanding returns over the past 18 months, there had been an obvious internal market rotation away from the sector in recent months as capital was recycled into lower-quality businesses that screened as relatively cheap versus the underlying market.

Similarly, broader cash holdings across domestic fund managers had appeared to grow elevated versus their historical averages (a combination of broader macro concerns e.g. escalating global trade tensions and weakness across emerging markets alongside the anticipation of pending share price volatility through results season), whilst short positions across higher-growth company names had also begun to materially increase.

As a result, while the market had been positioned for some retracement in fortunes across the growth sector (and for a re-rate in lower-quality, value-type businesses) various corners of the investment community were instead forced back into the market to aggressively purchase shares in a number of companies that had already taken on a rapid ascent. Of the above factors, **it's most likely the race to cover outstanding short positions provided the most meaningful amount of fuel to the fire**. In the final week of reporting season, for example, stocks with an outstanding short interest of more than 5% of the company (and a days-to-cover ratio in excess of 30 days) outperformed the underlying ASX 200 index return by some +6.8%.

Of course, not all share price moves this month were weighted to the upside, with **a number of equally spectacular share price falls experienced by those companies unable to meet overly optimistic consensus forecasts**. Momentum essentially works both ways and while the market rushed this month to support those businesses that displayed an ability to generate meaningful earnings growth, it has been equally prepared to flee those companies that were unable to meet expectations.

Interestingly (or, perhaps, frustratingly for those positioned for the broader recovery in value names), a large number of the more stellar share price declines this month came from businesses that one would most likely attribute to the value-end of the market. Ultimately, one purchases shares in lower-quality businesses in the belief that the price paid doesn't adequately reflect the ability of that business to generate a certain amount of future cash flows over time. Of course, in the event that these businesses don't see an improvement in their outlook, then the valuation discount will remain in place (or, as was the case this month, de-rate to previous levels). A number of notable moves in this camp included **Isentia Group** (ISD, -58.9%), **Speedcast International** (SDA, -36.1%), **ARQ Group** (ARQ, -31.6%) and **Pact Group** (PGH, -25.6%). Indeed, of the top ten worst industrial performers this month across the ASX Small Ordinaries, seven were businesses that one would classify as value stocks.

ASX Small Industrials – Ten Best and Worst Performers August 2018

Best			Worst		
Ticker	Name	Rel Perf	Ticker	Name	Rel Perf
APX	Appen	36.7%	ISD	Isentia Group	-58.9%
WTC	Wisetech Global	35.6%	RCR	RCR Tomlinson	-51.7%
RFG	Retail Food Group	34.5%	SDA	Speedcast International	-36.1%
IFM	Infomedia	33.1%	ARQ	ARQ Group	-31.6%
ALU	Altium	32.9%	BWX	BWX	-28.4%
BVS	Bravura Solutions	26.1%	CLQ	Clean Teq	-27.0%
APT	Afterpay Touch Group	23.4%	UPD	Updater	-26.2%
WEB	Webjet	22.8%	PGH	Pact Group Holdings	-25.6%
BRG	Breville	21.9%	SKT	Sky Network Television	-24.6%
NWH	NRW Holdings	19.4%	GEM	G8 Education	-21.8%

Source: Bloomberg.

In terms of broader trends, overall earnings 'beats' outnumbered the total 'misses' over the period (albeit marginally), although **forward-looking guidance, in aggregate, was surprisingly softer than initial market expectations**. As a result, net consensus earnings estimates for FY19 across the ASX 200 ended the month lower than where they started (and by quite some margin: almost three companies saw consensus forward estimates downgraded for every one that experienced a

positive revision). Average earnings per share growth across the Australian market for FY18 will likely settle in the ~8% range, with FY19 estimates now indicating a growth rate slightly below that.

Looking forward and despite an incredible deluge of company data, management meetings and follow-up analysis, our overall view on broader market direction and the opportunities from here remain much the same as when we entered the results period. With low global interest rates and domestic economic growth rates that continue to remain relatively subdued, **businesses that are showing an ability to deliver strong earnings growth rates - regardless of the cycle - will continue to command strong valuation premiums**. While we expect defensive growth businesses to continue to find long-term market support, we are cautious of the level of momentum ingrained in a number of these businesses, particularly where valuations are already reflecting significant upside (and faultless management execution) for many future years ahead.

Pleasingly, we're continuing to find new avenues in which to deploy capital selectively, however we also remain equally happy to retain any sales proceeds from realised investments in cash should no immediately attractive opportunities be available. Our general expectation for the remainder of the year is for continued equity market volatility (in addition to a further round of corporate activity / capital raisings) and we want to ensure we have sufficient capital available to take advantage of any opportunities as they present.

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

Kindest regards,

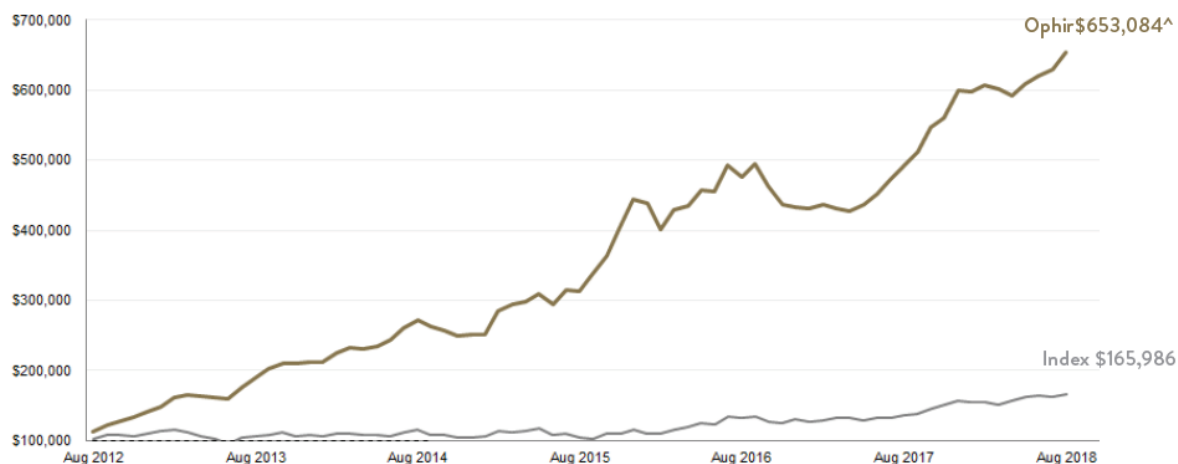
Andrew Mitchell & Steven Ng

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 +3.7% for the month, outperforming the benchmark by 1.2%. Since inception, the Fund has returned +553.1%, outperforming the benchmark by 487.1%.

	1 Month	1 Year	5 Year (p.a.)	Inception (p.a.)	Since Inception
Ophir Opportunities Fund (Gross)	3.7%	32.9%	28.0%p.a.	36.1%p.a.	553.1%
Benchmark*	2.5%	22.3%	9.2%p.a.	8.7%p.a.	66.0%
Gross Value Add	1.2%	10.5%	18.8%p.a.	27.5%p.a.	487.1%
Net Fund Return	3.6%	31.1%	22.5%p.a.	28.7%p.a.	364.1%

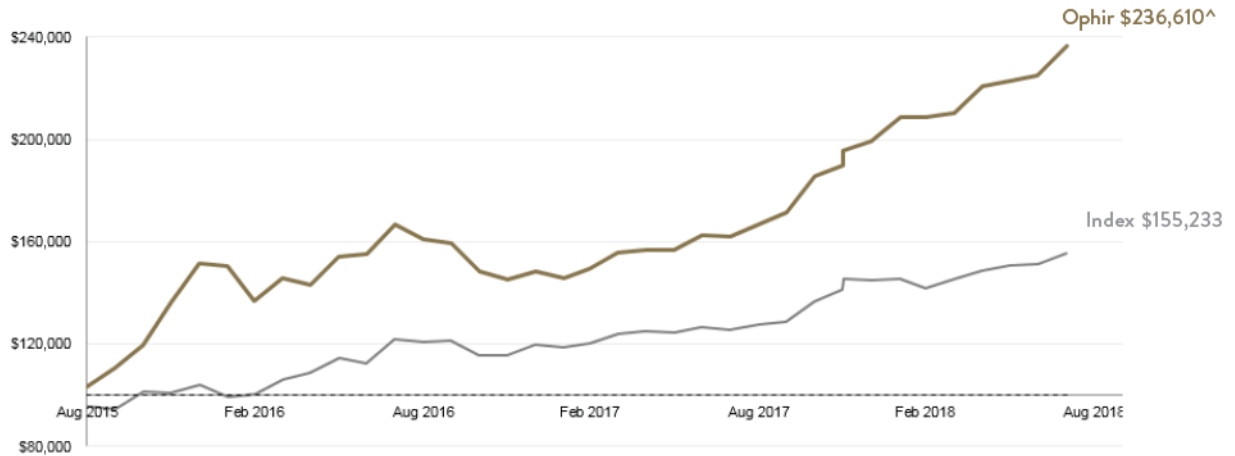
* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

	Buy Price	Mid Price	Exit Price
August 2018 Unit Price – Opp. Fund	2.5837	2.5747	2.5657

Key contributors to the Opportunities Fund performance this month included **Afterpay Touch (APT)**, **Pro Medicus Limited (PME)** and **Pinnacle Investment Management Group (PNI)**. Key detractors included **Capitol Health Ltd (CAJ)**, **Experience Co Ltd (EXP)**, and **Johns Lang Group Ltd (JLG)**.

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 +5.1% for the month, outperforming the benchmark by 2.3%. Since inception, the Fund has returned +136.6%, outperforming the benchmark by 81.4%.

	1 Month	1 Year	2 Year(p.a.)	Inception (p.a.)	Since Inception
Ophir High Conviction Fund (Gross)	5.1%	42.0%	21.2%p.a.	32.3%p.a.	136.6%
Benchmark*	2.7%	21.4%	4.2%p.a.	15.4%p.a.	55.2%
Gross Value Add	2.3%	20.6%	17.0%p.a.	16.9%p.a.	81.4%
Net Fund Return	4.5%	37.4%	18.4%p.a.	26.5%p.a.	105.9%

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

	Buy Price	Mid Price	Exit Price
31 August 2018 Unit Price – HCF	2.0221	2.0160	2.0100

Key contributors to the High Conviction Fund performance this month included **Afterpay Touch (APT)**, **Breville Gorup Ltd (BRG)** and **Webjet Limited (WEB)**. Key detractors included **Challenger Ltd (CGF)**, **Speedcast International (SDA)** and **Pact Group (PGH)**.

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