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Dear Fellow Investors,

Welcome to the **February 2019 Ophir Letter to Investors** – thank you for investing alongside us for the long term.

Month in Review

Equity markets continued their strong positive momentum this month, with risk assets globally benefiting from further supportive central bank commentary and the prospect of additional Chinese stimulus measures. US equities, particularly, continued their incredible run from the depths of their December 2018 lows to now posting the best two-month beginning to a calendar year since 1987. The euphoria embracing the region remains relatively market cap agnostic, with both the mega-cap Dow Jones Industrial index and the US small cap Russell 2000 index both posting eight consecutive weeks of positive gains – an outcome not achieved by each index since 1964 and 1984[1] respectively.

A cooling in US-China trade tensions combined with increased expectations for further domestic stimulatory measures has ignited an equally impressive turnaround from Chinese equity markets, the CSI 300 Index (tracking the top 300 companies listed on the Shanghai and Shenzen stock exchanges) rising +14.6% for the month. Indeed, the significant price gyrations experienced across the majority of global equity markets through the final quarter of 2018 now seem a distant memory, with the CBOE Volatility Index having now recorded nine straight weeks of declines – its longest continuous weekly regression on record.

	1 month	FYTD	1-Year	5-Year p.a.	Inception p.a.	Since Inception
Ophir Opportunities Fund^	3.8%	0.6%	2.6%	22.6%	32.1%	523.4%
Benchmark*	6.8%	(1.7%)	3.5%	7.7%	7.5%	60.9%
Value Add (Gross)	(3.0%)	2.2%	(0.9)%	14.8%	24.6%	462.5%
Fund Return (Net)	3.6%	(0.2%)	1.3%	18.0%	25.3%	340.3%

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

	1 month	FYTD	1 Year	3-Year p.a.	Inception p.a.	Since Inception
Ophir High Conviction Fund^	7.2%	2.9%	9.7%	18.7%	26.1%	129.1%
Benchmark*	5.9%	(1.4%)	2.2%	13.9%	11.7%	48.7%
Value Add (Gross)	1.3%	4.3%	7.5%	4.8%	14.3%	80.3%
Fund Return (Net)	6.9%	1.4%	7.2%	16.3%	21.1%	98.0%

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

On local shores, a half-yearly ASX reporting period that contained multiple anecdotes of increasingly tepid economic conditions did little to dampen the positive broader momentum toward equities. Helped by a significant post-Royal Commission relief rally across the index-heavy big banks and financials, the S&P/ASX 200 increased +6.0% for the month, while the S&P/ASX Small Ordinaries Index rallied +6.8%. **Both Ophir portfolios generated positive absolute returns for the month, the Ophir Opportunities Fund increasing +3.6% for the month (after fees), while the Ophir High Conviction Fund generated +6.9% (after fees).**

[1] The Russell 2000 was created in 1984 – until 2019, the index has not experienced eight consecutive weeks of positive gains.

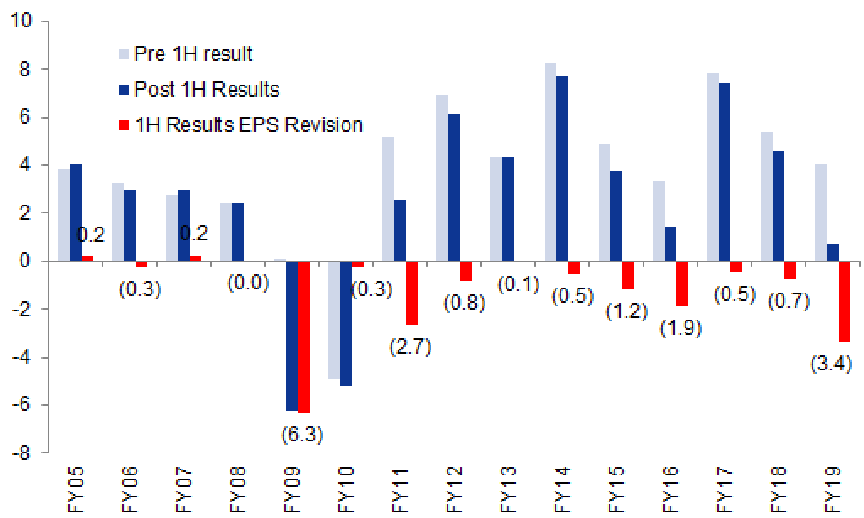
Strong absolute performances across domestic equities during the crucial company reporting periods of February and August generally tend to be a bullish indicator for near term market direction. One might normally assume that rising share prices (at the same time as 2,000+ companies deliver their periodic half-yearly updates) would indicate a market delighted with broadly better earnings results and improving future outlooks. However, the February 2019 reporting period has been somewhat of an anomaly in this regard, with the reporting period proving to be somewhat disappointing in aggregate versus consensus, with the bulk of index returns being driven by macro factors.

Indeed, a large bulk of the outsized returns delivered this month came from companies with a high proportion of their register held short that evidently delivered results that were simply 'less worse' than feared. As an indicator of the tough conditions currently facing the majority of domestic-facing businesses in Australia, **only 42% of the companies represented in the S&P/ASX 200 delivered any positive earnings growth at all for the first half of FY2019** – the weakest earnings performance by the index since the Global Financial Crisis.

That being said, the challenging conditions facing a wide proportion of Australian businesses at present have been a *'known known'* for some time and expectations coming into the reporting period across domestic-facing companies were already suitably low. Earnings estimates for the bulk of Australian housing, building and consumer-facing businesses, for example, had experienced fairly consistent negative revisions coming into the February results period – in effect ensuring the earnings bar had been set reasonably low.

As a result, overall earnings per share (EPS) 'beats' for the February reporting period were roughly in-line with historical averages, **although consensus earnings expectations for the second half of the financial year have again been revised materially lower**. Sluggish consumer demand (particularly through the final quarter of calendar year 2018), ongoing political and regulatory uncertainty and pockets of rising input cost pressures collectively created a raft of headwinds for businesses facing the domestic economy. While the resources sector – and the mining services and contracting business that service the industry – have enjoyed the benefit of strong commodity prices through the period, both the ASX 200 Industrials and ASX 200 Financials experienced their largest consensus downgrades to full-year growth forecasts since 2009.

ASX 200 Industrial EPS Revisions – Pre and Post 1H Results



Source: Goldman Sachs Investment Research, Factset

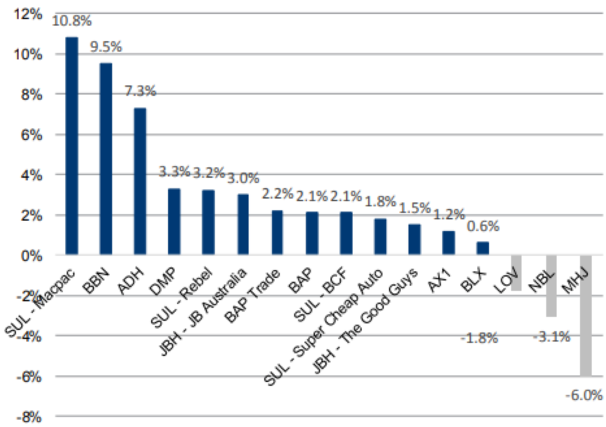
Unsurprisingly, the key takeaway after meeting with over 60 companies directly and a further 38 in group settings has been **the continuing tough conditions facing businesses reliant on the underlying strength of the Australian economy and/or consumer.** While expectations across the building materials, property development and housing-exposed retailers were already low, the pervasive impact from falling East Coast home prices (and the negative flow-on effects to consumer spending) again surprised to the downside. Consumer spending still represents c.60% of total Australian GDP per annum and the varied companies and sectors that have begun to register top line impacts from the consumer/housing slowdown have begun to broaden.

Gaming and entertainment group **Crown Resorts (CWN),** for example, commented its domestic premium gaming rooms in Sydney and Melbourne experienced softness through the December quarter, while pubs and bottle-shop operator **Redcape Hotel Group (RDC)** cited an increasing 'variability' in trade across a number of their venues over the September-December period. Automotive parts distributor and retailer **Bapcor Limited (BAP)** experienced softer performance from their retail and servicing divisions (consumers seemingly willing to defer the scheduled servicing of their cars through the quarter to conserve cash flow), while diagnostic imaging provider **Capitol Health (CAJ)** blamed a weaker first half result on a lower number of patients attending GPs through the first half.

Retailers, unsurprisingly, continue to face difficult market conditions albeit a large amount of the negativity had arguably been baked into valuations prior to February. As a result, the sector saw a number of fairly stellar moves upwards from a handful of businesses that delivered on prior earnings guidance amidst a consensus backdrop that had begun to assume peak pessimism. Considerably low expectations and a high level of short interest often proves a lethal catalyst for a share price re-rating, with the retail sector enjoying a number of significant turnarounds from the delivery of earnings 'meets' (not even beats!). Most notable included online travel provider **Webjet** (WEB, +30.6%), fast fashion retailer **Lovisa** (LOV, +39%), appliance manufacturer **Breville Group** (BRG, +45%) and natural beauty products wholesaler **BWX Limited** (BWX, +54%).

Interestingly, despite the continued negativity toward the sector, overall like-for-like sales growth (a measure used to determine the level of sales generated across a retailer's footprint, not including new or divested stores) were not diabolical, while trading updates provided for the first four-to-six weeks of the year appeared cautiously optimistic. In-store foot traffic continues to remain depressed across the majority of domestic retailers, however this has been offset by the continued and persistent growth in online transactions. While the impacts from a sluggish housing market will continue to weigh on consumer confidence near term, the possibility of household incomes receiving some respite near term from pre-election policy boosts may provide the sector with some additional support in coming months.

Like for Like Sales Growth – Small/Mid Cap Retailers



Source: Morgans

Outside of relief rallies experienced across some of the more beaten-up cyclical names, **it has again been the cohort of Australian businesses with international growth options that delivered the lion's share of earnings growth this period.** While the domestic economy continues to face a myriad of growth hurdles near term, Australian businesses with established channels into higher growth offshore markets (particularly the US and Asia) have been amply rewarded for their investment in overseas expansion. An Australian dollar now plumbing multi-month lows (sitting at c. US71c at the time of writing) provides an additional near-term attraction given the currency translation benefit of the AUD/USD retreating a further -4.8% over the first half of the financial year.

Notable performances from more offshore-facing businesses across our own portfolios included the impressive entry into the United States from modern day lay-by provider **Afterpay Touch (APT**), the business having now welcomed over 1 million US customers onto the platform (across 2,800+ retailers) just 10 months after launching in the country. Fast fashion jewellery retailer **Lovisa (LOV)** pleasingly recorded strong sales growth across a number of new territories in Europe and the USA (the business adding 12 additional stores in the UK, 5 stores in France, 3 stores in Spain and 7 in the US), while infection prevention medical device company **Nanosonics (NAN)** announced a further +9% increase in the global installed base of their infection prevention device 'trophon', including Europe, Asia, Australia and North America.

Elsewhere, aerial satellite imagery provider **Nearmap (NEA)** saw its market capitalisation break through $1 billion after announcing record growth in annualised contract value from its US operations (its seventh consecutive half of incremental growth out of the US), while plumbing supplies retailer **Reliance Worldwide (RWC)** again delivered over 20% sales growth across its marquee 'Sharkbite' push-to-connect fittings and accessories across its American territories (the business now ranging across US hardware mega-chains Home Depot and Lowe's).

While business conditions appear reasonably buoyant around the US, New Zealand and pockets of Europe, it is worth noting **some tempering in enthusiasm from companies exporting domestic goods into China.** Economic data through the region has continued to indicate a fairly material slowing in recent months, while anecdotally a number of China-facing businesses have highlighted increasing levels of domestic competition. Vitamins distributor **Blackmores (BKL)** provided the most notable example this month, the company experiencing a -27% share price decline after disclosing a heightened competitive environment for their products in China (the issue further exacerbated by some company –specific inventory management issues). Blood products manufacturer **CSL Limited (CSL)** noted a degree of pricing pressures creeping into their albumin product sales into the region, whilst industrial gloves retailer **Ansell (ANN**) commented that Chinese demand had slowed "rapidly".

As Australia's largest trading partner, any sustained loss in economic momentum out of China will create obvious challenges for a variety of businesses and sectors locally, albeit calls suggesting the near-term end of the Chinese growth story remain premature in our view. Indeed, while some businesses have faced challenges in the region in recent months, others continue to navigate the economic conditions well – portfolio holding **A2 Milk (A2M)** being one obvious example. We highlight the February result and our outlook for the company in this months' edition of 'Strategy Notes'.

Looking across the Ophir portfolios this month, we have been broadly happy with the performance of both strategies throughout the reporting period. The results season provides one of the more transparent tests of an investment team's investment process and methodology and we take great pride when delivering reasonable returns through the period and also in minimising significant exposure to earnings downgrades. In this regard we have delivered well, with only 5 earnings (or consensus) downgrades experienced over the cumulative 47 stocks held across both Ophir funds – a pleasing result.

Additionally, we have been equally pleased that a good number of larger weightings in each portfolio (i.e. those business that represent larger positions of the fund and ones in which we hold our highest level of conviction) benefitted from earnings upgrades through the month. The Ophir High Conviction Fund, our concentrated "best ideas" portfolio, was a significant beneficiary of this, with the fund exposed to earnings upgrades/beats across 6 of the portfolio's 22 holdings that reported earnings this month. Interestingly, despite significant increases in share prices across a number of holdings in the concentrated fund, **the level of conviction in the portfolio continues to remain high**: after meeting with 100% of the companies held within the portfolio (that issued earnings updates this month), we continue to retain the same 24 positions we entered February with, while only adding one additional name.

While the outlook for the Australian economy near-term remains challenging, we continue to feel the broader small and mid-cap equities space continues to provide attractive investment opportunities (particularly for those businesses displaying an ability to grow either offshore or independent of the domestic cycle). While conviction in the current portfolio remains high, we remain cognisant that we are operating within a market that is decidedly 'late cycle' and continue to expect further periods of volatility and macro uncertainty from here.

As a result, both portfolio's continue to retain a strong bias towards businesses we view as 'higher quality' (sustainable earnings, strong balance sheet, high returns on invested capital and pricing power), with both funds also favouring businesses further up the market cap curve. We continue to remain positive on the outlook and look forward to providing a number of updates on specific portfolio holdings to investors in coming weeks.

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

Kindest regards,

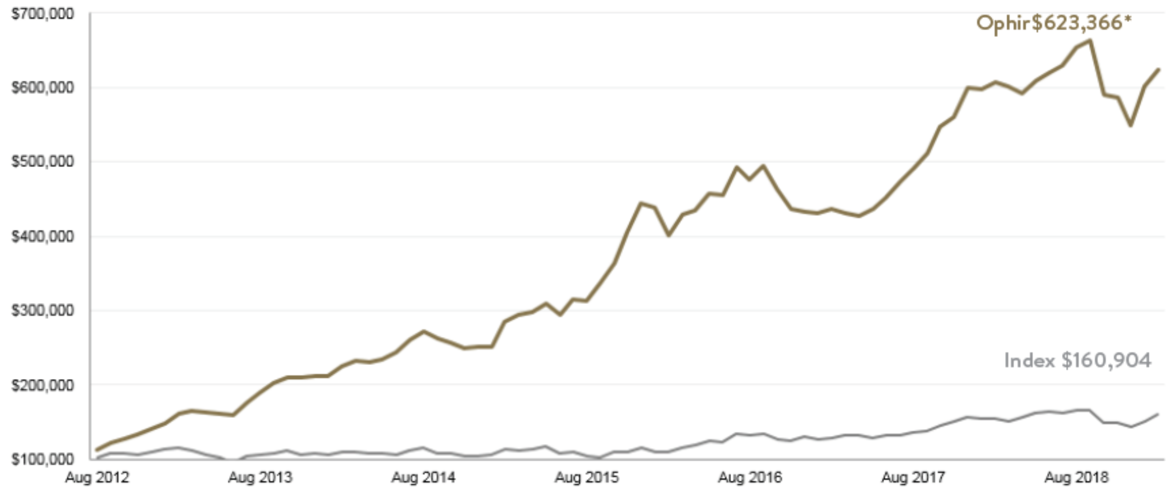
Andrew Mitchell & Steven Ng

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 +3.8% for the month, underperforming the benchmark by 3.0%. Since inception, the Fund has returned +32.1% per annum, outperforming the benchmark by 24.6% per annum.

	1 Month	1 Year	5 Year (p.a.)	Inception (p.a.)	Since Inception
Ophir Opportunities Fund (Gross)	3.8%	2.6%	22.6%p.a.	32.1%p.a.	523.4%
Benchmark*	6.8%	(1.7%)	7.7%p.a.	7.5%p.a.	60.9%
Gross Value Add	(3.0%)	(0.9%)	14.8%p.a.	24.6%p.a.	462.5%
Net Fund Return	3.6%	1.3%	18.0%p.a.	25.3%p.a.	340.3%

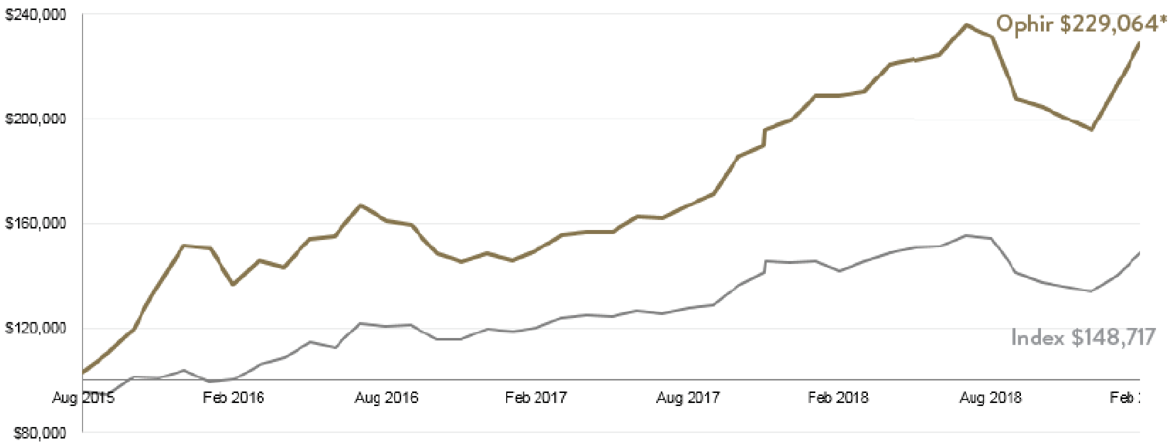
* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

	Buy Price	Mid Price	Exit Price
February 2019 Unit Price – Opportunities Fund	2.4509	2.4423	2.4338

Key contributors to the Opportunities Fund performance this month included **Afterpay Touch (APT), Jumbo Interactive (JIN)** and **Lovisa (LOV).** Key detractors included **Capitol Health (CAJ), Experience Co (EXP)** and **Smartgroup (SIQ).**

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 +7.2% for the month, outperforming the benchmark by 1.3%. Since inception, the Fund has returned +26.1% per annum, outperforming the benchmark by 14.3% per annum.

	1 Month	1 Year	3 Year(p.a.)	Inception (p.a.)	Since Inception
Ophir High Conviction Fund (Gross)	7.2%	9.7%	18.7%p.a.	26.1%p.a.	129.1%
Benchmark*	5.9%	(1.4%)	13.9%p.a.	11.7%p.a.	48.7%
Gross Value Add	1.3%	7.5%	4.8%p.a.	14.3%p.a.	80.3%
Net Fund Return	6.9%	1.4%	16.3%p.a.	21.1%p.a.	98.0%

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

	NAV
28 Feb 2019 NAV – ASX:OPH	$2.47

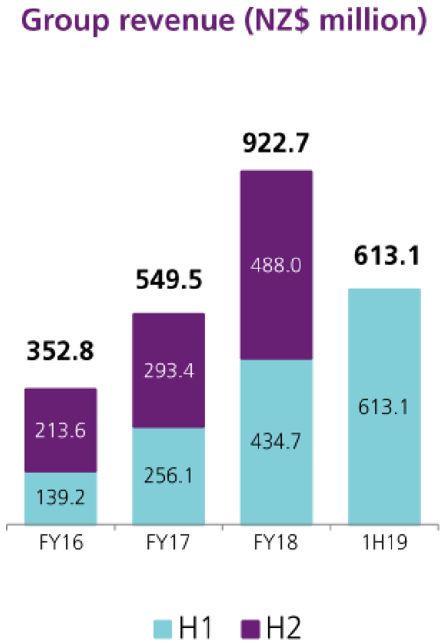
Key contributors to the High Conviction Fund performance this month **Breville Group (BRG), Cleanaway (CWY)** and **Seven Group Holdings** Key **detractors McMillan Shakespeare (MMS), NextDC (NXT)** and **Reliance Worldwide (RWC).**

<u>Strategy Notes – The A2 Milk Company – Still Milking It</u>

Never before in our memory can we recall a period where so many Australian small and mid-cap businesses have achieved such considerable success in overseas markets. Where offshore expansions have long been an investment graveyard for larger-cap Australian businesses desperately looking for growth avenues to supplement mature domestic market positions (see National Australia Bank, QBE, AMP, Wesfarmers/Bunnings amongst others), a new cohort of globally-focused emerging Australian companies have thrived in entering new territories.

Specialist dairy and infant milk formula producer **The A2 Milk Company (A2M)** has been one such notable performer, a business that only six years ago was a A$210m market cap NZ-based fresh milk producer generating $48.6m in revenues from the sale of bottled A2-only milk into supermarket chains in Australia and New Zealand.

Today, the same humble Kiwi milk producer now commands a market capitalisation of over A$9.7bn, selling fresh milk and infant milk formula (IMF) products into Australia, New Zealand, China, the US and UK and will deliver an expected ~A$1.25bn in revenue for the 2019 financial year. The business commands the number one market position for infant milk formula sales in Australia, already speaks for 5.7% of the $20bn Chinese infant milk formula market and recently announced A2-branded bottled milk now being sold in over 12,000 stores in the United States. **The business now holds more cash on its balance sheet that its entire market capitalisation in 2012.**



Source: A2 Milk Company Half Year Interim Results FY19 Presentation

The recently announced first half result from the company again highlights how far the business has come in recent years and the momentum it continues to see across all geographies and product lines. Group revenues grew +41% on the previous corresponding period, while earnings before interest, tax, depreciation and amortization (EBITDA) grew +53%. The result was a 8-10% 'beat' to underlying market expectations, with the stock subsequently rising +8% on the day.

Strong performance at the margin line was particularly noteworthy at this result, with gross margins across the business coming in at a healthy 55.5% as the company benefits from increasing scale, price increases and continued shift in sales mix towards the more profitable infant milk formula products. The margin performance provides an excellent example of the strength of the business given a material increase in recent months toward investments in marketing and brand.

Infant milk formula sales into China continue to be a key driver, with the business now benefiting from landing product into China via a variety of channels. Where initially the company saw enormous growth via the cross-border e-commerce channel (where individuals would purchase tins of A2 formula in Australia, take offshore and sell to Chinese parents via online market places such as Tmall or Taobao), the company now has an in-country presence in over 12,250 Mother and Baby stores, resulting in +83% growth in China-label tins from the same period last year.

While still only a small market by current revenue contribution, the growth the business has experienced this half in the United States is worthy of mention. Fresh milk sales in the US doubled over the period, with management noting they are seeing similar parallels to the brand building experience of their initial Australian roll-out – a pleasing anecdote considering the US milk market is worth in excess of US$13 billion per year with an underlying consumer already sympathetic to the alternative dairy market.

With further distribution agreements recently signed with national US supermarket chain Krogers and additional regions with Costco, Walmart and Safeway stores we expect the growth to continue to compound from here. **Importantly, it was the success of the fresh milk product in the Australian market that ultimately provided the company with the credibility required to underpin the success of its now immensely popular infant milk formula business** – a market opportunity within the US that isn't yet garnering significant investor attention.

With a large amount of runway left for the business in the two largest economies in the world, we continue to maintain confidence that the company will be a significantly larger one in years to come. Pleasingly, we entered February with the stock as the second largest held position across the Ophir Funds and we very much look forward to continuing to monitor and enjoy the business' growth from here.