Ophir Asset Management
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Dear Fellow Investors,

Welcome to the **July 2017** Ophir Letter to Investors – thank you for investing alongside us for the long term.

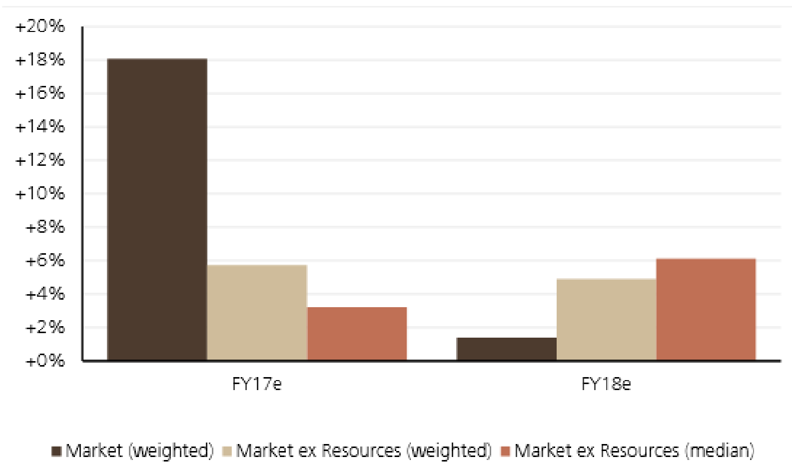
Month in Review

July produced a relatively benign month in terms of market action, with the Australian market nervously pacing out the period ahead of the pending data deluge that is the Full Year results season starting shortly in early August. As risk managers, the funds management community tend to be a nervous collective at the best of times and the July period tends to see this natural affliction gravitate up a notch. With the large bulk of domestic companies in self-imposed communication 'blackouts', investment managers are forced to simply sit tight and review their numbers and prepare for the flood of new information due to reach the market at the end of the month.

As such, the domestic market tends to take on a fairly random walk through the period as most managers will be reluctant to commit to new positions in the absence of any new information. The Small Ordinaries (+0.3%) again outperformed the ASX 100 (0.0%), though there was little to read into the moves given the disparity in performance largely came as a result of some singular stock specific events. For now, the market waits in eager anticipation of the pending results season and for a fresh insight into the broader health of the Australian listed corporate sector.

Our own expectations for the reporting period are for similar outcomes to those experienced at the half-yearly results in February. With an underlying economy that continues to remain suitably patchy, companies that deliver on earnings growth will be duly rewarded (though not excessively), whilst those that disappoint will likely experience a fairly swift negative response. Outside of some continued weakness in the retail space and the impact from a recently rising Australian Dollar, we're expecting the period to be relatively theme-agnostic where the bulk of positive outperformance will be driven by company-specific developments rather than any broad- based improvement in the cycle.

Australian Market EPS Growth Expectations



Source: UBS Investment Research

If we look across the consensus estimates for expected earnings growth, at an aggregate level the market is looking for FY17 EPS of ~18% growth, though the bulk of that will be carried by the resources names. Excluding resources, the number falls to more modest ~6%, again reflective of the broader low growth environment in which we currently find ourselves.

Investors will be taking a particular interest in the outlook statements from management teams to gain some insight into their confidence around the broader outlook and what can be expected for the year ahead – particularly given the recent rises in business confidence readings. Current expectations are for market earnings growth for next year in the 5-6% range (on an ex-resources basis), with the smaller cap industrials expected to deliver somewhere in the vicinity of 10-12%. Consensus estimates have a recurring habit of starting the year high and drifting lower over time and in our view we'd expect a continuation of the pattern for FY18.

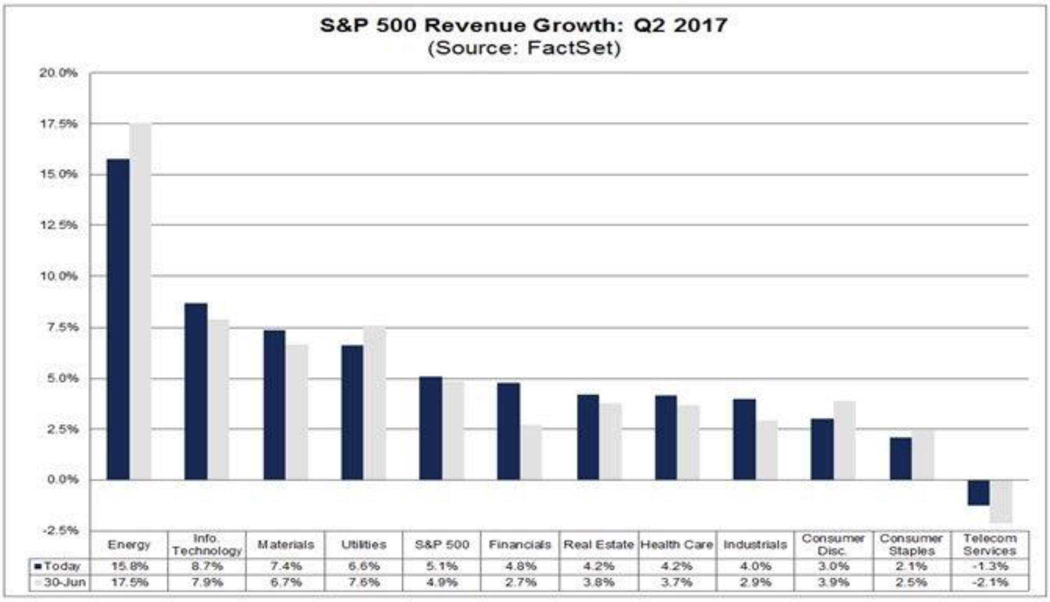
In a growth-constrained environment, **we continue to believe investors are best served holding high quality businesses that are demonstrating an ability to generate above market returns independent of the underlying cycle.** The pending reporting period will certainly provide an opportunity to demonstrate how much the market values these businesses in a period where the promise of a return to underlying inflation and a cyclical upswing has still yet to materialise.

Australian Dollar / US Dollar – 1 Year

As mentioned above, one potential swing factor for forward growth estimates will be **the recent strength in the Australian Dollar**, with the Aussie appreciating +4.1% against the US dollar over the month of July. Driven by the recent surprising weakness in the USD (the AUD is only +0.5% versus the Euro and +2.7% against the Trade Weighted Basket), this will have the potential to impact earnings translation for companies currently generating revenues in US dollar jurisdictions. While the strength has only been recent, we could see some sell-side analysts use the results season to slip in some currency 'mark to markets' for the offshore earners and we're mindful of the potential for some short term negative earnings revisions as a result.

We'll continue to monitor this closely as the portfolio's currently do retain an exposure to a number of companies that generate earnings in offshore markets. This positioning isn't the result of an underlying macro tilt based on our own internal views on the currency, but rather an outcome of the fact that a good proportion of Australian growth companies are simply finding more growth avenues in overseas markets rather than locally. Making short term calls on currency movements is a difficult task for even the most seasoned FX strategists and we can't assume some level of edge over the market in terms of where the currency trades from here. **Ultimately, we will position the portfolios for earnings growth, wherever that is being generated.** However, we note that our offshore growth options are suitably spread across a number of economic regions (Australia, the UK, US, Euro, Asia-Pac), providing us with some level of FX diversification.

The US second quarter reporting period is largely complete and the overall results have been broadly well received. With ~420 companies within the S&P 500 having now reported, 73% have beaten on EPS estimates and 70% exceeded expected sales growth. Performance has been fairly resilient across the board with 10 out of 11 sectors all reporting positive revenue growth. While encouraging, we continue to remain cautious on the near term outlook for US equity markets given the momentum of growth has continued to slow (noting the ‘beat rates’ for EPS, positive surprise and sales growth were all below those experienced in Q1), while ~50% of companies have subsequently seen their Q3 estimates revised lower. At the same time, the broader market continues to post new highs with an aggregate forward market valuation now nearly at a 4 PE point premium to the historical average (and now up 80% from the 2011 lows).



For us, the focus for August now turns squarely onto the domestic market and we look forward to gaining an update from our portfolio companies and (hopefully) uncovering some new investment opportunities. One continuing theme we are increasingly becoming aware of is the continuing impact from new technologies on existing traditional business models**. In this months ‘Strategy Notes’** we look at the emergence of the Australian fintech industry and highlight two investments in the Funds currently leveraged to the growth in online payments and cloud-based software solutions.

A Five Year Anniversary for Ophir

Investing provides participants with an endless education in humility and one obviously takes the perils of self-congratulation at their own risk, however, we were thrilled this month to recognise a fairly meaningful milestone for the Ophir business: the 4th of August marks the **5-year anniversary of the Ophir Opportunities Fund** and the **2-year anniversary of the Ophir High Conviction Fund**.

As detailed below, both funds have delivered in excess of 20% returns per annum to investors after fees and while we can never rely on the past emulating the future, we are immensely proud to have been able to deliver a reasonable return to the investor base that has supported us to date.

We set out in 2012 to establish an investment management business that could serve as a vehicle to manage our own investment capital (and those of family, friends and early institutional supporters) in a structure that would ensure the best possible environment to deliver outperformance. Our proposition to investors is simple and remains unchanged from when we first established the business five years ago. Specifically, we:

- offer capacity constrained, benchmark unaware investment funds focused on growth companies within the small and mid-cap equities space;
- ensure alignment with our investors by investing all our available invested capital in the Funds alongside them; and
- employ a fundamental, bottom-up research approach to identify businesses with the ability to meaningfully grow and compound earnings over time.

It has been an immensely rewarding experience for us and certainly not one without a multitude of lessons learnt along the way. We hope investors have found the journey equally fulfilling and we look forward to continuing to act as stewards of their capital for the next five years and beyond.

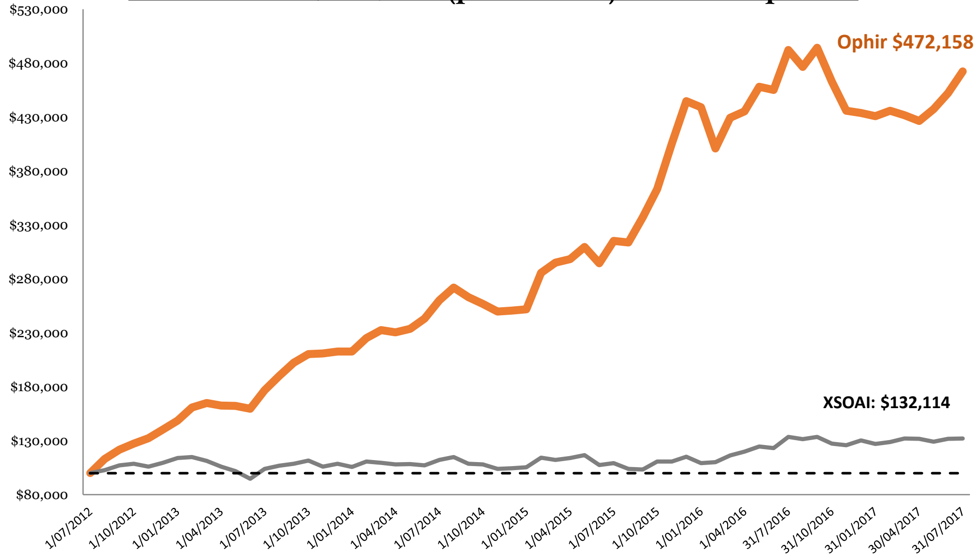
Thank you for your support.

- **The Ophir Opportunities Fund**
  - Achieved +372.2% gross performance since inception **August 2012 – July 2017**
  - Delivered +27.8% per annum return to investors after all fees.

- **The Ophir High Conviction Fund**
  - Achieved +61.8% gross performance since inception **August 2015 – July 2017**
  - Delivered +20.8% per annum return to investors after all fees.

The Ophir Opportunities Fund

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



The **Ophir Opportunities Fund** returned +4.4% for the month, outperforming the benchmark by 4.1%. Since inception, the Fund has returned +372.2%, outperforming the benchmark by +340.0%.

	1 Month	6 Months	1 Year	Inception (p.a)	Since Inception
Ophir Opportunities Fund (Gross)	4.4%	9.6%	-4.1%	36.4% p.a.	372.2%
Benchmark*	0.3%	4.0%	-1.1%	5.7% p.a.	32.1%
Gross Value Add	4.1%	5.6%	-5.2%	30.7% p.a.	340.0%
Net Fund Return	4.3%	8.9%	-5.4%	27.8% p.a.	240.3%

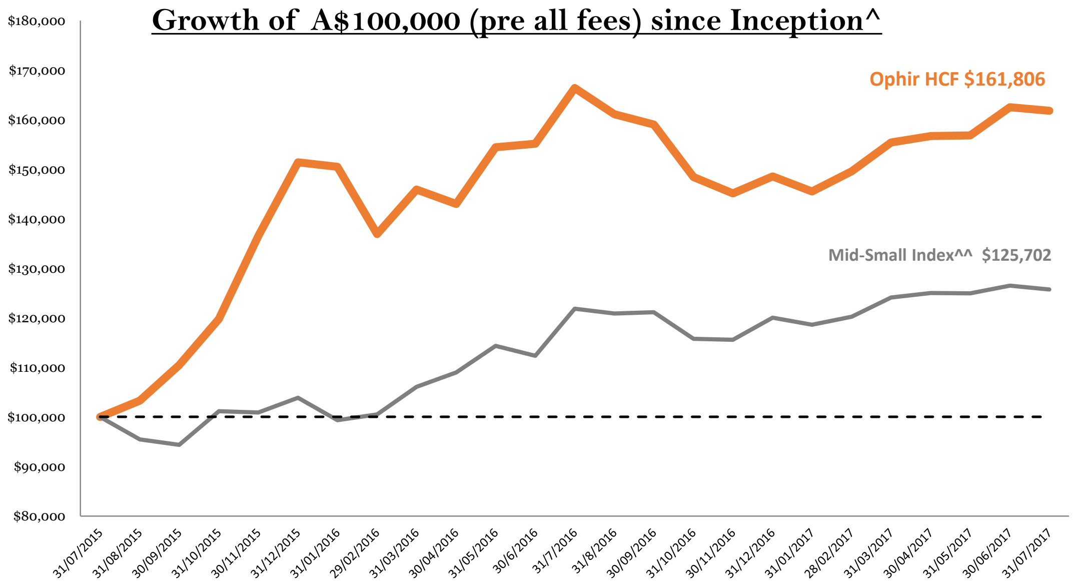
* S&P/ASX Small Ordinaries Accumulation Index (XSOAI)

	Buy Price	Mid Price	Exit Price
July 2017 Unit Price – Opportunities Fund	2.2316	2.2238	2.2161

Note Unit Prices for July are ex-distribution.

Key contributors to the Opportunities Fund performance this month included **Metals X Limited (MLX), Pushpay Holdings (PPH)** and **Oceania Health (OCA).** Key detractors included **Breville Group (BRG), Webjet Limited (WEB)** and **NextDC (NXT).**

The Ophir High Conviction Fund



The **Ophir High Conviction Fund** returned -0.5% for the month, outperforming the benchmark by 0.2%. Since inception, the Fund has returned +61.8%, outperforming the benchmark by +36.1%.

	1 Month	6 Months	1 Year	Inception (p.a)	Since Inception
Ophir High Conviction Fund (Gross)	-0.5%	11.2%	-2.9%	27.3% p.a.	61.8%
Benchmark*	-0.7%	6.0%	3.2%	12.2% p.a.	25.7%
Gross Value Add	0.2%	5.2%	-6.1%	15.1% p.a.	36.1%
Net Fund Return	-0.6%	10.5%	-4.3%	20.8% p.a.	45.6%

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

	Buy Price	Mid Price	Exit Price
June 2017 Unit Price – High Conviction Fund	1.4502	1.4451	1.4401

Note Unit Prices for July are ex-distribution.

Key contributors to the High Conviction Fund performance this month included **The A2 Milk Company (A2M), Premier Investments (PMV)** and **CBL Corporation (CBL).** Key detractors included **Webjet Limited (WEB), Magellan Financial Group (MFG)** and **NextDC (NXT).**

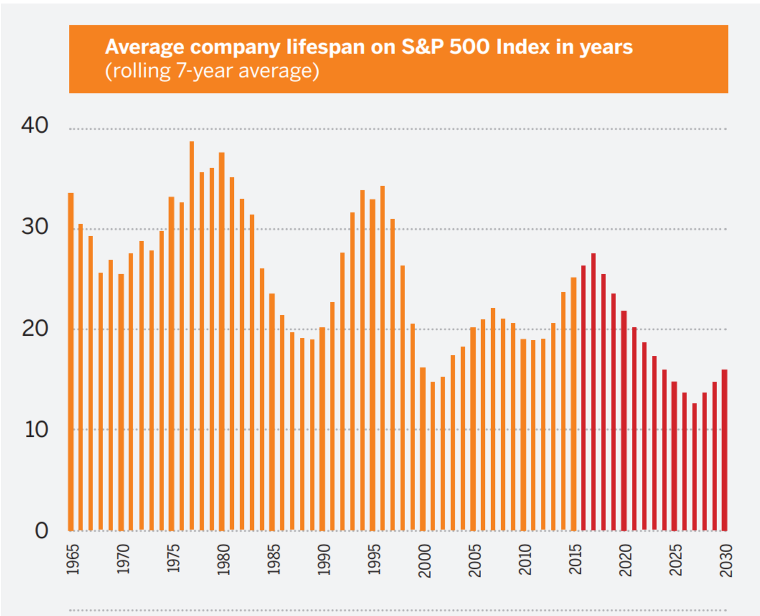
Strategy Notes – The growth and growth of Australian Fintech

We have written fairly extensively in recent times around the widespread growth in disruptive industries and the increasingly fluid nature of the corporate landscape at present. While owner-managers of disruptive start-up businesses have perhaps never felt gifted with so many opportunities, the leadership teams of traditional incumbent businesses have never faced a more uncertain period in which to allocate capital.

To understand how pervasive the theme of change has become in corporate leadership today, a statistic from the recent **Harvey Nash / KPMG Global CIO Survey** conducted at the beginning of 2017 certainly provided a sobering view: of the nearly 4,500 Chief Information Officers (represented across 86 countries), some 25% have now moved to actively reduce the level of long term planning in their business (i.e. over three years) in response to the growing level of uncertainty in the global outlook.

It is quite extraordinary to consider an environment where capital allocators now feel increasingly reticent to invest in growth and innovation projects with a time horizon any longer than 36 months. With the corporate and technological landscape changing so rapidly at present, corporations are essentially now fearing that any initiatives implemented beyond a 3-year time period will soon be made redundant and ultimately serve as a waste of shareholder funds. In a strange corporate paradox, large businesses are now refusing to invest in long term innovation in fear of ultimately being superseded by competitive threats that have been generated as a result of businesses investing in long term innovation!

It would be of no surprise that the bulk of concerns come primarily from the larger cap, slower-moving incumbent business models that for so long have enjoyed such significant competitive advantages. A recent study into corporate longevity by consulting business Innosight highlights the average tenure of companies in the S&P 500 in 1965 was 33 years – this is forecast to fall to just 14 years by 2026. As the impact of innovation and new business models continues to impact the turnover rate of companies with the S&P 500, **at current churn rates it is expected that almost half of the S&P 500 will be replaced over the next 10 years.**



Source: Innosight

The Australian equity market is dominated by a similar selection of large incumbent business models that now face their own existential threats. We have written previously about…