Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Performance as at 30th April 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund^	**5.6%**	**33.2%**	**80.8%**	**13.0%**	**14.4%**
*Benchmark**	*5.0%*	*21.4%*	*39.8%*	*9.1%*	*10.6%*
Value added	0.6%	11.8%	41.0%	3.9%	3.8%
*Microcap Index ***	*7.5%*	*28.6%*	*82.0%*	*14.5%*	*13.8%*

^ Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes. All p.a. returns are annualised.

* Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

** Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.

Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance.

Commentary

Spheria Australian Microcap Fund returned 5.6% (after fees) in April, outperforming it's benchmark by 0.6%.

Markets

Markets were higher over the month of April albeit performance was highly bifurcated. Gold and gold equities performed strongly after a multiple month price consolidation as breakeven inflation rates rise while Central Banks evince an intention to keep rates low. Battery material stocks continued to rally as investor exuberance for all things electrification reached new highs. Copper and related stocks rallied to new record highs in Australian dollars on the back of confidence about economic recovery, bullishness on the demand prospects from electrification and some non-fundamental activity by financial players. Coal stocks performed poorly on weaker commodity pricing and poor operational performance from several of the Australian listed market participants. Travel related stocks struggled during the month as unrelenting negative newsflow about the admittedly sad and desperate COVID-19 situation in India offset improvements in case counts, hospitalisations and deaths in most developed world markets as vaccination rates rise in these markets. A coterie of formerly high-flying technology and biotech stocks saw meaningful retracement in their share prices either on the back of weak guidance or commentary (e.g. NXL.ASX (-20%). RBL.ASX (-18%), KGN.ASX (-8%) or as they retraced following exuberant share price movement (e.g. Telix (-13%), SPL.ASX (-12%)).

Despite this month's retrenchment in some of these momentum names (compounding in some case major falls over previous months) we continue to observe, at a high level, a market with enormous disparities in valuation metrics. Stocks seen as leveraged to popular thematics (e.g. electrification, E-Commerce, Fintech and Biotech) remain exceptionally richly valued (particularly in the context of their often modest to non-existent cash generation) whereas many companies with proven business models in less popular areas of the market continue to trade on very modest multiples of earnings and cashflows.

The drivers of these valuation disparities appear to be a heady mix of "free money" from Central Banks' zero interest rate policies and quantitative easing, the COVID-19 induced surge in retail investor participation in the

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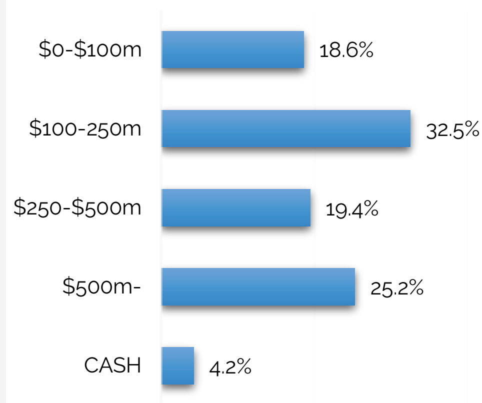
Top 5 Holdings

Company Name	% Portfolio
Michael Hill Int	4.7
Supply Network	4.4
Vista Group Int	4.1
Class	3.8
NZME	3.7
Top 5	**20.7**

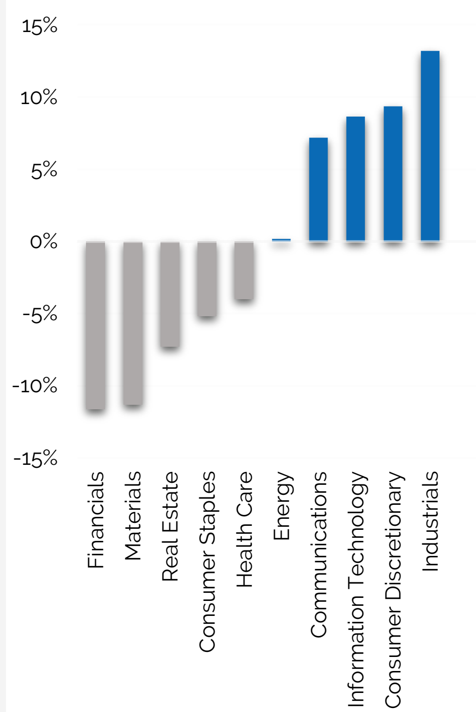
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

sharemarket, passive flows from index and sector specific ETFs along with quant strategies that have overwhelmingly favoured momentum as a factor in stock selection. We admit to being somewhat perplexed at this continuing bifurcation and the fascination with other highly speculative assets like cryptocurrencies when economic growth is strong and many companies with proven cash generative business models continue to trade on cashflow multiples that haven't been bid up by ultra-low interest rates.

We would note for instance that at the time of writing "dogecoin" which is a cryptocurrency based on an internet meme about a Shiba Inu dog, which has unlimited supply (i.e. no scarcity potential) and no use cases has an incredible US$60 billion market cap. That is roughly the market capitalisation of ANZ which is forecast to make more than A$9 billion of operating profit in FY22 and operates in an oligopolistic first world banking market. While we can't know when these valuation disparities are likely to close we feel it prudent to stick to our strategy of buying proven cash generative business models rather than chase the next hot trend.

Major Contributors for the Month

Michael Hill (MHJ.ASX) was the largest contributor to returns after jumping 31% following a very strong 3Q21 trading update. We still believe the business screens very cheaply trading at 4x FY21 EV/EBIT and expected to finish the year with roughly $50m of net cash (from a net debt position pre pandemic). Unlike some consumer discretionary businesses that were major COVID-19 beneficiaries due to share of wallet and stay-at-home demand we think the pandemic has been net neutral to negative for Michael Hill due to the jewellery category being one that is heavily reliant on instore selling (and thus impacted by store closures in Australia, NZ and Canada).

Nitro Software (NTO.ASX) contributed as it rose 27% over the month. While we are typically cautious on unprofitable technology stocks we are attracted to Nitro's multi-billion dollar global market in business productivity software, its customer value proposition relative to its exceedingly richly valued peers in Adobe and Docusign and its demonstrated ability to move through the typically painful process of shifting from licence to subscription billing while reducing its already modest EBITDA loss. At c7x EV/Sales and with a balance sheet sufficiently strong to fund many, many years of its modest current cash losses we see Nitro as reasonably valued if it continues to make the strong progress on top line and EBITDA that it has been delivering recently.

Universal Store Holdings (UNI.ASX) contributed after reporting an exceptionally strong 3Q21 trading update with comp stores sales up an incredible 37%. Universal is now lapping six years of double-digit positive like for like sales, yet this extremely impressive youth-oriented retailer continues to go from strength to strength. At 11x FY22 EV/EBIT the stock still screens attractively to us given its exceptional ROIC and strong growth prospects through store rollout and online growth.

Major Detractors for the Month

Supply Network (SNL.ASX) was the largest detractor as it fell 7% on no news. The stock had returned 10% over the month prior and appears to have been used as a funding source during the month. Supply Network has a long track record of double-digit organic top and bottom-line growth at a ROIC north of 30%. At c13x FY22 EV/EBIT the stock continues to screen well to us.

Class (CL1.ASX) dragged on returns as the stock retraced another 7% over the month on no newsflow. We remain comfortable that Class' management team has built a platform for solid earnings growth with the launch of the new adjacent Class Trust product and the entry into the documents and corporate compliance space. At 3.2x revenue and 12x EV/EBIT (annualised 12m forward) for a growing and solidly profitable cloud software business we believe Class is hugely undervalued.

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Helloworld (HLO.ASX) detracted as it fell 13% over the month on pessimism towards the timing around the re-opening of borders and the recovery in travel demand and guidance around the expected return to breakeven that disappointed the market. We continue to like the name given the long liquidity runway ($75m of free cash vs. a forecast cash burn this quarter post JobKeeper and without meaningful benefits from travel bubbles of $3-5m) and very modest multiple post recovery (we forecast it trading on a low single digit EBIT multiple in FY23). With the company guiding to a 1H22 that should be around or slightly better than breakeven on the back of domestic leisure and corporate travel and some modest international travel from travel bubbles, we feel Helloworld is a solid risk/reward proposition.

Outlook & Strategy

We continue to see valuation as our North Star so to speak to navigate a highly speculative and choppy market. While it is easy to be distracted by investor exuberance towards sectors benefiting from a popular "thematic" we prefer to focus on buying cash generative business models, with a track record of solid returns and at sensible valuations. The volatility caused by the heightened activity of retail, passive and quant investors in the market continues to present us with opportunities to re-invest cashflows from positions we are exiting into new names with the characteristics that we are after. Namely quality businesses with good cash generation potential and strong balance sheets on sensible multiples.

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	Spheria Australian Microcap Fund
Benchmark (universe)	S&P/ASX Small Ordinaries Accumulation Index
Investment objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.
Investing universe	Primarily listed companies outside the top ASX 250 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Distributions	Annually
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee
Cash	• Up to 20% cash • Typically 5% - 10%
Expected turnover	20-40%
Style	Long only
APIR	WHT0066AU
Minimum Initial Investment	$100,000

Platform availability
ASGARD
BT Panorama
BT Wrap
HUB24
IOOF Portfolio Service
Macquarie Wrap
mFund
MLC Wrap / Navigator
Netwealth
One Vue
uXchange