# Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

## Performance as at 30th April 2021

| | 1m | 6m | 1yr | 3yr p.a. | Inception p.a.# |
|---|---|---|---|---|---|
| **Fund ^** | **2.9%** | **28.2%** | **45.8%** | **11.1%** | **12.3%** |
| *Benchmark** | *5.1%* | *18.6%* | *42.9%* | *10.4%* | *11.6%* |
| Value added | -2.3% | 9.6% | 2.9% | 0.7% | 0.7% |

^ Spheria Opportunities 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 Mid-Small Accumulation Index.

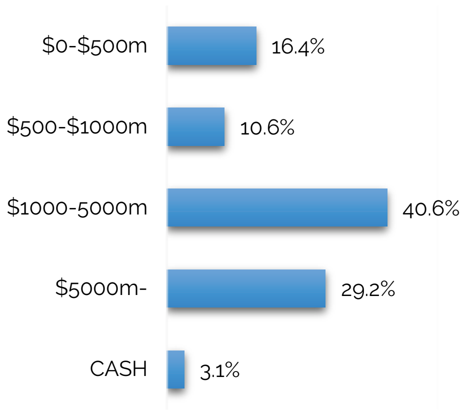
# Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance.

## Top 5 Holdings

| Company Name | % Portfolio |
|---|---|
| Crown Resorts Ltd | 5.5 |
| Orora Limited | 4.8 |
| Fletcher Building | 4.2 |
| Als Ltd | 4.2 |
| Bega Cheese Ltd | 3.9 |
| **Top 5** | **22.6** |

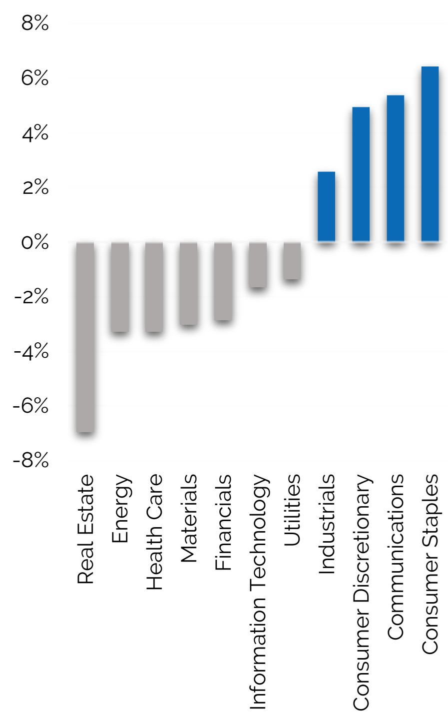
Source: Spheria Asset Management

## Market Cap Bands




Source: Spheria Asset Management

## Active Sector Exposure




Source: Spheria Asset Management

## Commentary

Spheria Opportunities Fund returned 2.9% (after fees) in April, underperforming it's benchmark by 2.3%.

### 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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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).

**City Chic (CCX.ASX)** added meaningfully to performance as the stock returned 18% on investor expectations that City Chic should be benefiting from strong operating conditions in all three of its end markets (Australia, United States and United Kingdom). While we are cautious about the medium-term prospects for retailers that have benefited meaningfully from the pandemic (e.g. furniture, brown and whitegoods) we believe this concern is much less relevant to an apparel retailer like City Chic where end market demand was hurt by the pandemic (particularly the subcategories like occasional wear that are driven by the desire to go out). City Chic has re-rated meaningfully (now trades on 20x FY22 EV/EBIT but still screens as reasonable value relative to much more highly rated peers like Temple & Webster (TPW.ASX) given its predominantly online revenue profile, strong topline growth and exceptional return on invested capital.

**Monadelphous (MND.ASX)** contributed to performance during the month returning 23% following the announcement that it had successfully settled a large claim from Rio Tinto following a fire at the Cape Lambert Iron Ore processing plant that Monadelphous was providing maintenance operations on. Monadelphous still screens very cheaply to us trading on c10.5x FY22 EV/EBIT and sitting on a net cash balance sheet of over $200m by year end.

### Major Detractors for the Month

**Blackmores (BKL.ASX)** was the largest detractor as it fell 10% on the back of cautious commentary at its investor day due to weaker immunity product sales and aggressive discounting activity in Chemist Warehouse by other brands with excess stock due to reduced daigou activity in the Australian market. We continue to view Blackmores as well placed to grow its earnings at above market rates as the business rebuilds profitability in its manufacturing operations and benefits from strong top line growth in its South-East Asian franchise.

**Incitec Pivot (IPL.ASX)** detracted as it fell 9% on the back of delays and cost overruns on the turnaround of its Waggaman ammonia plant in Louisiana. While we share the market's frustration with the unacceptable level of plant reliability that management have delivered, we remain attracted to the firm's collection of explosive and fertiliser operations in Australasia and North America. China's more rational actions in the ammonia market

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(effectively ceasing to export ammonia at a loss when they are a major and growing primary energy consumer and want to reduce GHG emissions) appear to have rebased fertiliser profitability upwards yet this does not appear to be reflected in the share price of Incitec Pivot.

**Flight Centre (FLT.ASX)** detracted as it fell 7% over the month on pessimism towards the timing around the re-opening of borders and the recovery in travel demand given the unrelenting negative newsflow out of India. We are more constructive on the name as are conscious that Flight Centre's corporate business (accounted for 38% of the company's TTV pre pandemic and 68% of the underlying profit pre unallocated costs) is primarily a domestic business within each of its major operating territories and has been gaining substantial market share in tender wins. While Flight Centre's leisure business is heavily leveraged to Australian outbound travel (and therefore in aggregate is unlikely to improve until Australian borders re-open) we would note it still has meaningful exposure to markets which are already recovering (e.g. United States where FLT disclosed its leisure business was already profitable over March and April, Canada and the U.K).

### 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.

# Spheria Opportunities Fund

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| | Spheria Opportunities Fund |
|---|---|
| Benchmark (universe) | S&P/ASX Mid-Small Accumulation Index |
| Investment objective | The Fund aims to outperform the S&P/ASX Mid-Small Accumulation Index over the medium to long term |
| Investing universe | Primarily listed companies outside the top 50 ASX listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation |
| Distributions | Half yearly |
| Fees | 0.99% p.a. management fee & 15% performance fee of the Fund's excess return versus its benchmark, net of the management fee |
| Cash | • Up to 20% cash<br>• Typically 5% - 10% |
| Expected turnover | 30-40% |
| Style | Long only, risk aware |
| APIR | WHT0025AU |
| Minimum Investment | $25,000 |