Spheria Australian Smaller Companies Fund

ARSN 117 083 762 APIR WHT0008AU

Performance as at 30th April 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	**3.4%**	**29.2%**	**55.9%**	**11.8%**	**12.3%**
*Benchmark**	*5.0%*	*21.4%*	*39.8%*	*9.1%*	*9.8%*
Value added	-1.6%	7.7%	16.1%	2.7%	2.4%

^ Spheria Australian Smaller Companies 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.

Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2005. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Fletcher Building	4.7
Adbri	4.2
Flight Centre Travel	3.8
Monadelphous Group	3.7
Healius	3.6
Top 5	**20.0**

Source: Spheria Asset Management

Commentary

Spheria Australian Smaller Companies Fund returned 3.4% (after fees) in April, underperforming it's benchmark by 1.6%.

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

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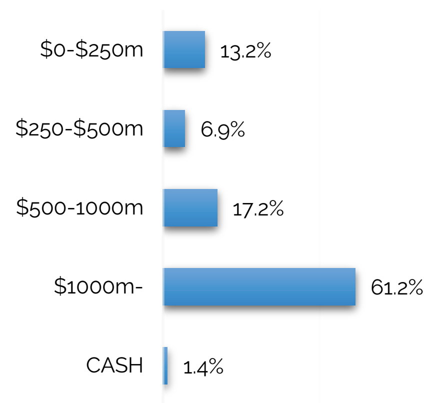
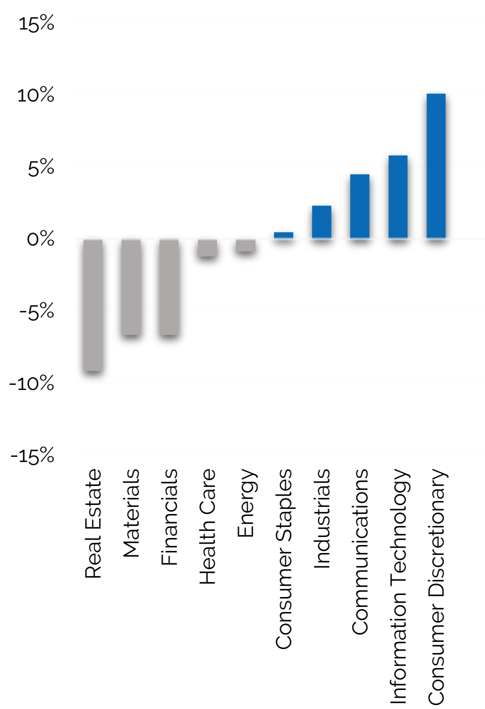
Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

quantitative easing, the COVID-19 induced surge in retail investor participation in the 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

Monadelphous (MND.ASX) was the largest contributor 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.

Lynas (LYC.ASX – Not owned) contributed positively as it retraced more than 10% over the month as the price for the key permanent magnet rare-earth of Neodymium-Praseodymium (NdPr) oxide fell approximately 25% from the record highs reached in early March. While we acknowledge the growth in EVs and wind turbines (the key end markets for this material) should be very strong we also note that vehicle and turbine makers are spending considerable funds to reduce and / or eliminate the usage of this material through substitution with alternate materials and / or technologies (e.g. Low temperature superconducting magnets in the case of turbines, switched reluctance motors in the case of EVs). More fundamentally we would note that rare earths are not actually very rare. The current extremely high price for this material is well above the incentive price required to induce new supply growth. The massive valuations being ascribed to potential producers is likely to see several raise sufficient capital to move into production over the medium term.

Michael Hill (MHJ.ASX) contributed positively 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).

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.

Adbri (ABC.ASX) detracted as it fell 5% on no newsflow over the month. We believe the market is overly bearish about Adbri's prospects for replacing the earnings lost when AWAC chose not to extend Adbri's lime supply contracts to its WA alumina refineries. We remain attracted to Adbri's market positioning in cement and lime and

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believe in the strategic rationale for its $200m investment in its Kwinana cement operations. At 15x forward EBIT (with upside risk in our view on both cement and lime) and potential to realise value through its landbank Adbri remains attractive in our view.

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.

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 Australian Smaller Companies 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 100 ASX listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Distributions	Half yearly
Fees	1.10% 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	30-40%
Style	Long only
APIR	WHT0008AU
Minimum Investment	$25,000

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