Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Performance as at 31st August 2020

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund^	**13.5%**	**1.1%**	**-3.3%**	**1.0%**	**6.8%**
*Benchmark**	*7.2%*	*4.6%*	*2.1%*	*8.0%*	*8.0%*
Value added	6.2%	-3.5%	-5.4%	-7.0%	-1.2%
*Microcap Index ***	*14.6%*	*22.9%*	*11.8%*	*10.9%*	*9.4%*

^ Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes

* 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 13.5% (after fees) in August, outperforming it's benchmark by 6.2%.

Markets

Markets had a strong August over the reporting season with investors broadly relieved that results were in line or in many cases better than feared. Whilst sell side consensus saw on balance negative revisions, the share price reactions from many stocks suggest that investors had already factored in a worse scenario. The mandate was a beneficiary of the moves in August with many of our holdings performing strongly after releasing their annual results.

The recent reporting season was as we predicted "noisy" with results buffeted by many factors. Some companies partially or fully qualified for the Job Keeper allowance and saw a quick rebound in revenues post March and April. Others didn't qualify and saw no re-bound. In some cases, businesses saw rental abatements and in others, landlords were not so forgiving. Generally, the market was willing to look through short term numbers and rewarded stocks with positive outlooks. Stock in the discretionary retail sector report reported well with home furniture retailers, electronics other discretionary retail all reporting strong results and very positive short-term trading outlooks. Conversely travel and leisure stocks like Village Roadshow (VRL.AX), Corporate Travel (CTD.AX) and Flight Centre (FLT.AX) all reported tough trading conditions albeit that the Job Keeper allowance and rental abatements mitigated the worst of the revenue shortfalls. As the world awakens from the worst of the COVID-19 impacts we would expect consumer spending to normalise to a degree.

The market has been gyrated by two major distortions – the first being a "stimulus distortion" which has seen many people receive the Government's Job Keeper allowance of $750 a week (even if they were earning materially less than this) and the early withdrawal of Super. The second being an "interest rate distortion" driven by even lower rates and the increasingly consensual view that these will stay low for a long period of time. The stimulus distortion has been further exaggerated by consumers inability to spend in certain categories (eg. Travel and Leisure) and thus funneling additional spending where they can.

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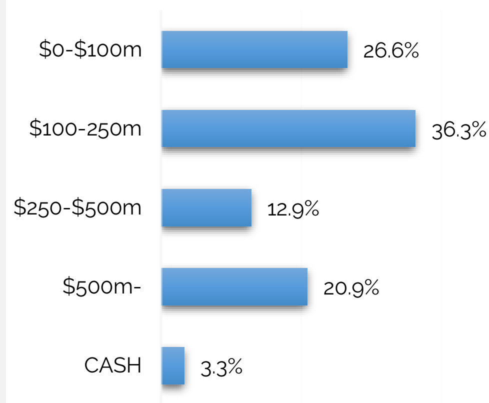
Top 5 Holdings

Company Name	% Portfolio
Class Limited	4.8
Mortgage Choice Ltd	4.6
Vita Group Ltd	4.1
Supply Network	3.9
City Chic Collective	3.8
Top 5	**21.1**

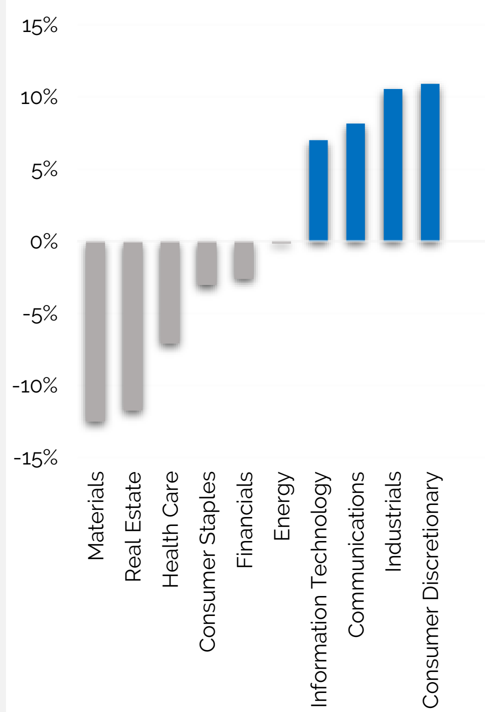
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

This has meant more money for homewares, electronics and household furniture as people stay at home and spend the Job Keeper allowance (its far easier to spend money you haven't actually had to earn than to spend one's savings.).

The interest rate distortion has created a topsy turvy world. The more you lose the more valuable you are in this upside-down world. At least that is the experience in the small cap space over the last 12 months. A simple backward-looking screen at the small and micro caps comparing companies that made operating cash flow with those that didn't shows that those that didn't hugely outperformed. The simple average of the returns of the two groups shows that negative cash flow companies returned on average 108% to the end of August versus 18% for those with positive operating cash flow. The perverse logic here is that you will pay more for companies that will (or more accurately could) earn cash tomorrow than those that do today. This only makes sense if discount rates are actually negative. Whilst many short-term rates around the world are slightly negative most long bonds are still in positive (albeit only slightly) territory. Unless the world really has lost its economic gravity, the market has generally sent these types of stocks back down to earth with a sharp thud and eventually re-rated profitable businesses. It is with this backdrop that we believe it is now – more than ever – time to focus on the fundamentals. If there is even a hint of inflation, the longer term bond will sell off increasing the required yield (interest rates) to own longer term bonds which will likely see a sharp reversal of this topsy turvy view of the world.

Investors need to distinguish between perceived wealth generation (share prices moving up with little in the way of sustainable businesses and earnings to support them) and actual wealth generation (creation of new goods and services supported by sustainable business models). Over the last year in small caps there has been a plethora of the former and precious little of the later. It is extremely unlikely that ultra-low interest rates have been solely responsible for such sustainable wealth creation alone. Innovation, scientific breakthroughs, new networks, and strong end demand are some of the ingredients for business to be sustainable. Businesses without cashflow are like the cayote chasing Roadrunner over the cliff – suspended in midair before he realises that he's run out of road. In the US there has been a boom of retail investors using a platform called Robinhood. Robinhood charges investor zero commission but hands off all the investor orders to "market makers" who pay Robinhood for the trading flow. If you aren't paying for the product you are the product...

Major contributors to performance were:

Class Ltd (CL1.AX) was the largest contributor for the month as the stock returned 39% on the back of strong results and a very positive trading outlook. CL1 has lagged many of its SAAS peers on account of the perceived smaller market TAM compared to some of its peers. The results presentation highlighted their continued market share gains in the SMSF space plus the opportunity they have in the Trust space (through Class Trust) and the document and corporate compliance markets (through NowInfinity).

Vista Group (VGL.AX) rose 40% over the month as they reported results which whilst impacted by COVID-19 demonstrated that the company had materially cut costs and was able to generate substantial cash flow. Vista's outlook has also improved as its Cinema customers have started to re-open around the world. The business has trimmed some unnecessary costs and believe these will remain out of the business on a go forward basis.

NZME (NZM.NZ) rose 62% over the month from a very oversold position coming into results. NZM reported a very strong result given the soft media market. Whilst clearly a beneficiary of the NZ governments wage subsidy, they have also managed to control costs and generated decent cash flow further reducing gearing. NZM has substantial opportunity to monetise their extremely high online readership across NZ. Currently a very small proportion of users pay for their online news plus they are establishing a strong number two property portal in NZ. Most global markets have one or two online papers which have successfully migrated their customer base to an online paywall. NZM remain in a prime position to achieve the same in NZ.

Major detractors to performance were:

IDP Education (IDP – not owned) was the largest detractor as it rallied 51% on delivering a better than expected 2H20 result and more positive current revenue trends than the market had priced in.

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ZIP Co (Z1P – not owned) detracted significantly as it rose 54% on positive sentiment towards the buy now pay later space and in response to the announcement of a deal to provide finance to eBay Australia vendors. This was despite it reporting materially worse than expected FY20 results and analysts meaningfully downgrading forward EPS expectations.

Outlook & strategy going forwards

We are staying the course with our investment philosophy to buy cash flow rich businesses at sensible valuations based on their fundamental position and industry dynamics. During the month we saw some recognition of the extent of undervaluation of our portfolio companies with some strong bounces seen from heavily oversold levels. The current topsy turvy world in smaller companies will revert at some point and we believe fundamentals remain more important today than ever.

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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