Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

Performance as at 31st August 2020

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	**7.3%**	**-0.1%**	**-5.1%**	**4.7%**	**7.0%**
*Benchmark**	*6.7%*	*7.1%*	*4.4%*	*8.7%*	*8.9%*
Value added	0.6%	-7.2%	-9.6%	-4.0%	-1.9%

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

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

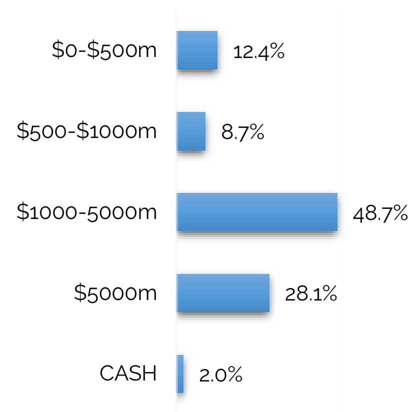
Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Als Ltd	5.3
City Chic Collective	4.7
Crown Resorts Ltd	4.2
Incitec Pivot	3.9
Tpg Telecom Limited.	3.7
Top 5	**21.8**

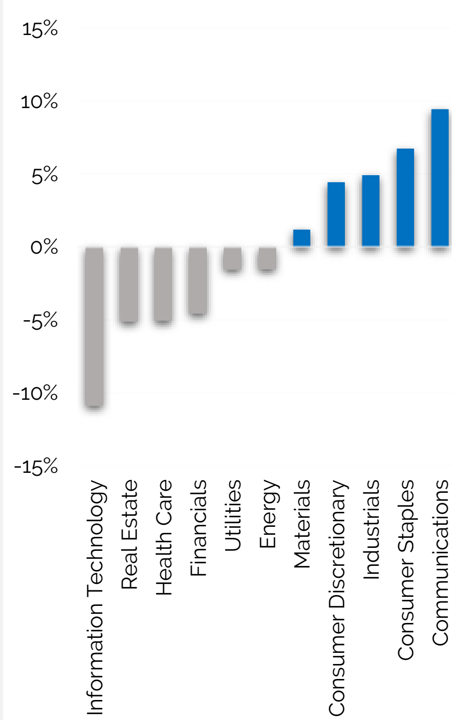
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Commentary

Spheria Opportunities Fund returned 7.3% (after fees) in August, outperforming it's benchmark by 0.6%.

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 Fund 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 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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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 mid air 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. Its worth remembering if you aren't paying for the product you are the product…

Major contributors to performance were:

Class Ltd 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 behind 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).

Flight Centre (FLT) rebounded strongly over the month (returning 25%). FLT has been significantly impacted by the Covid 19 travel restrictions. We took part in the capital raising back in April as we felt the business had raised enough capital to see it through the worst case Covid 19 scenario. FLT announced that is had reduced its pre covid cost base by almost 70% and closed around 50% of their store base. In the medium term we believe FLT will re-emerge with a greater proportion of their business online and in the more profitable Corporate Travel segment.

Monadelphous (MND) Also reported a reasonable set of number (especially when adjusted for the one off impacts of their water infrastructure business which impacted h2 resuls to the tune of $14m). Covid 19 also slowed down both construciton and maintenance work at MND such that the company believes around 10% of Fy 20 revenues have been pushed forward largely into FY 21. Looking forward, MND has won significant work in the Iron Ore space as major assets get depleted and all the Iron Ore majors are required to invest heavily in new mines to maintain output. Their increasing maintenance business provides a high quality, low risk earnings stream to compliment their construction business. Their balance sheet remains strongly net cash and valuation remains appealing despite the rise post results.

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Major detractors to performance were:

Afterpay (APT – not owned) Afterpay continued to rise over the month on the back of an acquisition in Europe – thus effectively announcing its expansion into a new market and an "underlying" profit result that beat its own guidance announced a few months prior. APT is an excessively rated growth stock in our view that is still yet to turn a real profit let alone any real cash flows. A litany of competitors have listed and are looking to compete in the BNPL space and thus our view is that the business model is likely to come under significant medium term threat. In addition there remains significant regulatory risk as APRA and ASIC are both examining potential regulatory threats.

XERO Ltd (XRO – not owned) rose 12% over the month as they announced continued customer wins from March to July and the acquisition of small business lender Waddle. XRO's customer acquisition growth over the first 4 months was just 96,000 subscribers indicating an annualised subscriber growth rate of just 12%. This is well down on historical growth rates – albeit with the backdrop of Covid 19 globally. Whilst we remain fans of XRO's business we believe there are more attractively valued technology investments elsewhere in the market.

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

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.

	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 • Typically 5% - 10%
Expected turnover	30-40%
Style	Long only, risk aware
APIR	WHT0025AU
Minimum Investment	$25,000