Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

Performance as at 31st July 2021

	1m	6m	1yr	3yr p.a.	5yr p.a.	Inception p.a.#
Fund ^	**-0.3%**	**12.3%**	**44.9%**	**10.1%**	**11.0%**	**12.2%**
*Benchmark**	*0.7%*	*12.0%*	*33.1%*	*10.7%*	*11.0%*	*12.0%*
Value added	-0.9%	0.3%	11.8%	-0.6%	0.0%	0.2%

^ 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. All p.a. returns are annualised.

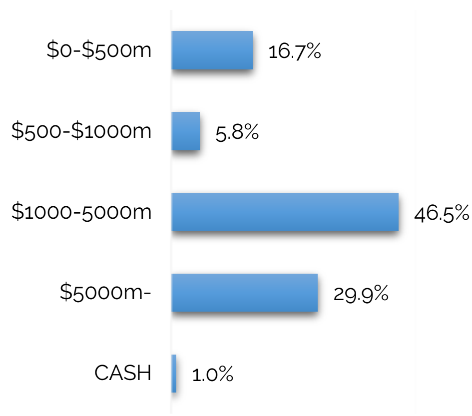
Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Orora Limited	7.2
Als Ltd	4.8
Blackmores Limited	4.6
Seven West Media Ltd	4.3
Incitec Pivot	4.3
Top 5	**25.2**

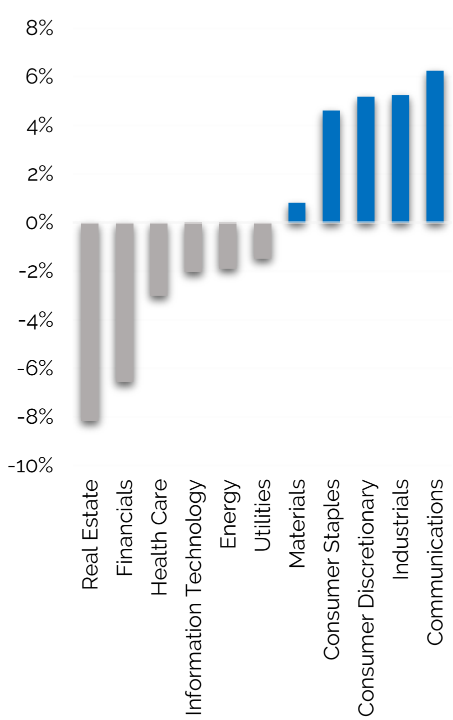
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Commentary

The Spheria Opportunities Fund returned -0.3% (after fees) during the month of July, underperforming the ASX Mid-Small Accumulation Index by 0.9%.

Markets

Markets rose modestly over July as the market digested the likely positive news from reporting season – lead by some strong early earnings reports in overseas markets countered by the outbreak of the Delta Strain of Covid 19 locally which has seen many States re-initiate lockdowns. New age metal stocks continued to be a highly favoured area for investors with Galaxy Resources (GXY.ASX), Orocobre (ORE.ASX) and Lynas Rare Earths (LYC.ASX) all up strongly despite strong performances in previous months. Mining services as a group saw some recovery as the investors re-appraised the inflationary costs impacts against relatively cheap valuations and a recovering topline. At the other end of the ledger were some e-commerce names. These had benefitted enormously from last year's lockdown and are finding it hard to lap extremely high comparable sales and profit margins. For many of these internet retailers last year customers flocked to their websites and they grew substantially with less than usual marketing spend. As the consumer market normalises the cost of customer acquisition has grown substantially with attendant rise in overall marketing costs squeezing margins.

Enter the Matrix

With rates having declined again since the blip in February this year, the market has returned to its matrix-like state. Many investors appear to be ignoring risk or it is deemed irrelevant. In a forgiving market, emboldened by seemingly endless Central Bank liquidity, the reddit army marches on seeking justice against an unknown and largely imaginary enemy. We liken this state to the choice Morpheus offered Neo in the Matrix Movie. Will you take the Blue Pill and re-enter your slumber plugged into the machine or the Red Pill and unplug?

Red-Pill like thinking requires you to unplug from the slumber many investors appear to be in and look at reality. We are in an extremely unusual set of market conditions, largely set by Governments and Central Banks in reaction to firstly the GFC and then the outbreak of Covid. Ultra-loose monetary conditions were a likely cure for the 2008 GFC which, after all was

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a financial crisis. However, we have used the same prescription to cure the "patient" of an entirely different set of circumstances with Covid. Nevertheless, rates at zero or negative levels are not likely to remain a long-term possibility. Alternatively, if they are the new reality there are multiple other repercussions with which the market is yet to grasp. These would include a rapid debasement of monetary purchasing power (aka inflation), a spike in assets likely to protect wealth – viz property, gold, artworks and collectibles and probably severe social repercussions. Sound familiar? Blue-pill thinking is the unthinking adoption of this status quo without thinking about the attendant consequences. Blue-Pill thinking is following the herd into whatever is deemed growthy, disruptive and innovative without any heed to business fundamentals or sustainability of the business.

We recently did a presentation in an attempt to demonstrate the futility of following the crowd into momentum names that did not subsequently back up strong share price performance with fundamentals – that is earnings and cash flow. The study focused on micro caps where there are the greatest proportion of listed companies that lose money, but we believe the analysis would also apply to small caps. We went back and analysed the top 10 performing microcaps in each of the past 7 years to see whether the Sturm und Drang surrounding the best performing short term names proved warranted over time. In most of these years well under 50% of the top 10 made money and in many 8 or 9 of the top 10 names lost money. Inevitably, if these companies didn't subsequently earn money or cash flows these erstwhile fireworks morphed into damp squibs. In every year over the ensuing timeframes (of 2 years or longer) the money-losing high-flyers vanished back into the ether from which they came in many cases literally costing investors everything they invested.

Flipping the analysis on its head we also went back to look at the starting point of the subsequently best performing microcaps over a 10-year period. 9 out of 10 of these names were money making and the consistent trend amongst these names was that they had growing earnings and cash flows and were creating sustainable and durable businesses. As we have said before we prefer to work with probabilities rather than improbabilities. Why gamble on low probability stocks when you can win consistently on higher probability stocks. Cash flows are the beating heartbeat of any great long-term business and eventually all durable businesses generate cash flows.

Major Contributors for the Month

Incitec Pivot (IPL.ASX) added 12% over the month. After consistently disappointing the market with a series of poor operating updates surround their shutdown process in Waggaman in the US, it was pleasing to see the group release a positive update during July. IPL is exposed to rapidly increasing ammonia prices as demand for their end products (explosives for the quarrying and mining industries) and fertilizer see strong cyclical recoveries. Globally we see the likelihood of supply dynamics further improving with more rational behaviour from Chinese manufacturers.

Orora (ORA.ASX) was another contributor as the shares rose 8% over the month. ORA's shares have continued to strengthen over the past 6 months on an improving outlook for the US business which is the largest part of ORA's revenue base. ORA has turned out to be a good play on the US re-opening with parts of the business exposed to retail trade marketing (point of sale displays and brand marketing). After their disposal of the Australian Fibre business, they have fully executed their 10% share buyback and well below current share price levels – adding value to long term-oriented shareholders in the process. We continue to believe their remains reasonable upside to ORA's earnings forecasts which are still only forecasting a very modest recovery in FY 22 and beyond.

Seek Ltd. (SEK.ASX – not owned) helped relative performance of the Fund as the shares declined 12% over the month on the announcement of a CEO transition and some early detail around the spin out of SEEK's Early-Stage Investment vehicle. Whilst SEK remains an attractive online asset, given that margins are already reasonably full and growth in core markets relatively mature that better opportunities lie elsewhere in the mid/ small cap space.

Major Detractors for the Month

Crown Resorts (CWN.ASX) declined 27% over July as it continued to air its dirty laundry after being dragged

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through a total of 3 Royal Commissions. There is little doubt the group could have done a significantly better job on many grounds (including a number of ESG issues) and runs the risk of fines, additional regulation and possible license revocation. On the other hand, the group is now through the development of its flagship Sydney casino property in a geographically advantaged location and is in the process of selling its 82 apartments for boom time prices. Once sold we estimate net debt will be a very modest circa $500m. Earnings are likely to remain impacted for some time due to Covid 19 restrictions and there could be either restrictions or some form of restructuring of their casino operations. We had reduced our holding at levels above the Blackstone bid over the last several months but now believe the shares are again materially undervalued especially considering the > $4.0bn of property on the balance sheet (at historical cost) in the midst of a strong tightening in most commercial property asset class capitalisation rates. We also believe the market is potentially overestimating the downside from licence revocation given that the enabling legislation at worst would see Crown lease its casino to another party at market rent. Whilst this would lead to meaningful value leakage to the new operator it does not mean the properties cease being of value to Crown shareholders. Whilst a frustrating holding, we believe there will be a better outcome for shareholders than the current share price suggests.

Bega Cheese (BGA.ASX) detracted as the stock declined 12% on concerns that higher farmgate milk prices would potentially squeeze earnings. Whilst input pricing has risen this year, supply still appears to be relatively constrained as dairy farmers are still recovering from drought conditions last year. Herds and farmers take time to adjust to pricing signals before adding capacity. BGA still has substantial cost savings opportunities and synergies from their recent acquisition of Lion Dairy Drinks business. We feel the business is well positioned to perform over the medium term despite some short-term input pressures.

Mineral Resources (MIN.ASX – Not owned) increased 17% over the month as Lithium mania kicked into full over drive. July saw a continued recovery in Spodumene (Lithium Concentrate) and Lithium Carbonate prices. Whilst MIN has a substantial Lithium resource, we continue to hold the view that many of these Lithium mining names look over-valued on longer term assumptions and the inevitable supply response to high lithium prices and demand.

Outlook & Strategy

As the market goes through various fixations with sectors and themes our view remains that ultimately earnings and cash flows derive long term valuation and returns. We are clearly at an interesting juncture in time with rising environmental concerns coupled with a likely once in a generation energy transition (or transitions) likely to open up new business streams and opportunities. Mankind is, to give us some credit, a reasonably creative species especially given enough incentive. On the other hand, as the research above demonstrated, new areas, ideas or disruptive business models must eventually make earnings and cash flows to warrant share price performance or meet the market's eventual contempt.

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