Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Spheria ASSET MANAGEMENT

Performance as at 30th June 2021

	1m	6m	1yr	3yr p.a.	5yr p.a.	Inception p.a.#
Fund^	**3.8%**	**18.4%**	**81.2%**	**14.1%**	**15.3%**	**15.0%**
*Benchmark**	*3.1%*	*10.8%*	*33.2%*	*8.6%*	*11.2%*	*10.9%*
Value added	0.8%	7.6%	47.9%	5.5%	4.0%	4.0%
*Microcap Index ***	*-1.2%*	*11.8%*	*59.2%*	*14.9%*	*12.7%*	*13.5%*

^ 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. All p.a. returns are annualised.

** Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.

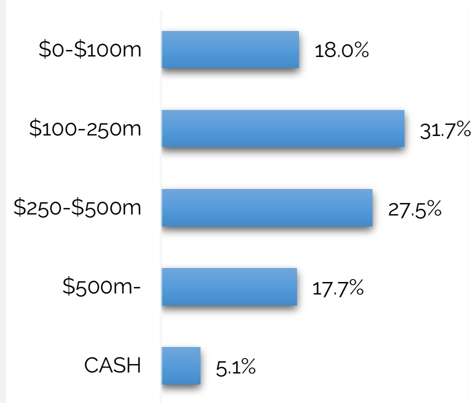
Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Supply Network	4.9
Michael Hill Int	4.4
Class Limited	3.9
Vista Group Int Ltd	3.8
Seven West Media Ltd	3.5
Top 5	**20.5**

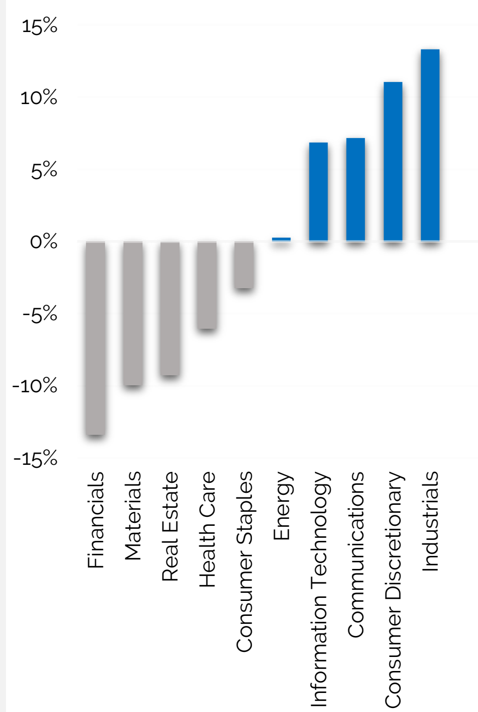
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Commentary

The Spheria Australian Microcap Fund returned 3.8% (after fees) in June, outperforming the benchmark by 0.8%. Over the quarter to the end of June, the Fund rose 11.0%, outperforming the benchmark by 2.5%.

Markets

Markets locally rose over June with strong returns in particular in a narrow subset of high momentum technology names and in materials names exposed to popular thematics (e.g., lithium, mineral sands) and to coal following strong price rises in both coking and thermal coal. Gold fell 7% over the month with equity exposures similarly coming under pressure. Despite the benchmark WTI price rising almost 10% over the month oil and gas names were mixed. Several technology stocks made record absolute highs and re-rated to record EV/Sales multiples despite no material newsflow. These included Pro Medicus (PME.ASX), Megaport (MP1.ASX), Realestate.com.au (REA.ASX) and Seek (SEK.ASX).

Most re-opening trades were neutral to down for the month following the emergence of the delta strain in the U.K. (originally responsible for the second wave in India) which has seen a strong resurgence of cases (mostly amongst children and young adults and the unvaccinated), albeit with a much less pronounced rise in hospitalisations and no material increase in deaths. Locally we observed some strong negative share price reactions to weaker than expected earnings forecasts e.g., Nuix (NXL.ASX) and Integrated Research (IRI.ASX) or other negative newsflow, e.g., Nuix (NXL.ASX) on management resignations and ASIC investigations and Genworth (GMA.ASX) following the Commonwealth Bank (CBA.ASX) announcing it will put to tender its lender's mortgage insurance volumes that currently go to Genworth. Corporate activity was elevated over the month with Altium (ALU.ASX) rejecting a proposal from Autodesk of the U.S., Isentia (ISD.ASX) receiving a recommended bid at a 154% premium to the last price, Reckon (RKN.ASX) having 19.9% of its shares acquired by Novatti (NOV.ASX) and the media reporting that IRESS (IRE.ASX) was the subject of a failed raid on its register during the month.

The Fund outperformed due to an overweight to media, retail and gaming exposures, the sale of its holding in Isentia (ISD.ASX) at a 154% premium to last and the sale of its holding in Reckon (RKN.ASX) at a 27% premium to last.

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Despite our recent outperformance we continue to observe and remain concerned about speculative excess in high momentum names although we have noted a narrowing of the field of names that continue to re-rate as some former high-flyers have come down to earth following disappointing newsflow. While some COVID-19 beneficiaries in the e-Commerce, Fintech and Biotech space have de-rated (albeit in most cases to levels that are still well above our measure of value), these appear to have largely been replaced by cohorts of stocks within the materials space that are seeing price action that is difficult to justify. In particular, those companies exposed to popular thematics (e.g., battery materials and rare earths) appear to be capitalising near record high prices and enormous margins well out into the future - far beyond time horizons that one can credibly forecast and in some cases in direct opposition to the likely impact on supply and demand caused by current trends (i.e., expensive share prices equals a low cost of capital for new supply in these materials).

Given the significant rise of passive, quantitative and direct retail investors in the market and the unprecedented liquidity that Central Banks have injected into the financial system we should perhaps not be surprised that valuation disparities are at levels not seen since the dot.com boom and that price momentum can push valuations to extreme levels. We are trying to remain disciplined and weight the portfolio towards more 'boring' and relatively unpopular names with proven, high returning, cash generative business models that remain at multiples below their historical relative trading ranges. Given rising inflation (both measured inflation and inflation expectations) that is being generated by high levels of fiscal and monetary stimulus alongside shortages of raw materials and certain intermediary goods (e.g., silicon chips) we are mindful of purchasing companies with pricing power that should be better placed to maintain margins in an inflationary environment. If Central Banks eventually take the punchbowl away (or at least stop spiking it with vodka) we are hopeful that our focus on purchasing undervalued securities should impact us less than the market more broadly which is currently paying extreme multiples for firms that are ***forecast*** to have strong outer year growth. In the meantime, the high levels of liquidity appear to be feeding an M&A cycle that should support our returns given our focus on buying undervalued, cash generative businesses with underleveraged balance sheets means our portfolio companies are more often the target of this activity than the average index constituent.

Major Contributors for the Month

Ainsworth (AGI.ASX) was the largest contributor as the manufacturer of gaming machines rallied another 27% to end the financial year up 349% from the nadir it hit in mid-November. Whilst the pandemic has significantly negatively impact Ainsworth's operations the firm has never been in danger of insolvency given property holdings in the U.S. that at one point exceeded its market capitalisation. The end market of casinos, pubs and clubs in its two major markets of Australia and the United States have recovered strongly and in many cases are now in a position to recommence expenditure on new machines. As a result, the group returned to profitability in the 2H of the financial year. New management in our view has made sensible changes to personnel to improve the product development cycle which we feel have been obscured by the pandemic. We still see potential for Ainsworth to leverage its valuable portfolio of intellectual property and regulatory approval to improve earnings well above the level it was generating prior to COVID-19.

Maxitrans (MXI.ASX) contributed as the nation's largest manufacturer of trailers rallied 28% following the receipt of a $7.2m settlement from its consultant for a botched ERP software rollout. This builds on an already modestly net cash balance sheet position at the 1H21 result and represents a remarkable turnaround from a company that little more than two years ago had net debt of $52m. We continue to see value in MXI.ASX given its mid-single digit forward EV/EBIT and the fact that the firm's truck and trailer parts distribution division is implicitly trading at a substantial discount to comparable listed operations.

Seven West Media (SWM.ASX) contributed to attribution given the company's 16% return over the month on the back of a stronger than expected earnings update and better than expected net debt reduction. Seven West Media continues to screen extremely cheaply with an EV/EBIT of c4x despite a subset of the earnings coming from

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activities that would normally attract very high multiples (e.g. transmission towers and the production studio). With net debt now well under control (less than 1x EBITDA) we feel confident there remains significant returns to be derived from this position.

Major Detractors for the Month

Geopacific Resources (GPR.ASX) was the largest detractor as it retraced almost 15% despite finalising its project funding facility with Sprott for the development of its Woodlark Island project and declaring final investment decision now that the project is fully funded to completion. We believe tax loss selling played a major part in this price action with the stock up 12% since the June financial year end. We still see Geopacific as incredibly undervalued trading at a market capitalisation of less than $180m despite $143m of cash as at March 31, 2021 and having spent $33m on the project. This effectively implies a net present value of zero for the project despite a robust bankable feasibility study that generates a post-tax NPV8 of A$347m at a A$2,200 gold price (vs. spot of A$2,400). We also see scope to add materially to this base case given strong in pit, extensional and regional exploration potential and our view that the conservative assumption around mining dilution (30%) on the orebody is likely to lead to positive reconciliation once the project commences production during the second half of 2022.

Donaco (DNA.ASX) detracted as the stock fell 25% as investors fretted over the firm's ability to amortise its (albeit very modest) remaining US$6.8m debt given the current suspension of its operations as a result of COVID-19. This debt was taken on in 2016 when DNA.ASX purchased its flagship Star Vegas Resort and originally amounted to US$100m. Subsequent to period end the firm announced that it had entered into a new extended amortisation schedule over 6 months to December 2021 and raised a new 3 year, US$9.2m facility. We anticipate this new facility should be sufficient to pay the amortisation payments and the modest corporate costs of the company for the foreseeable future. Trading at less than a third of NTA and < 1.5x our best estimate of mid-cycle EBITDA we believe the stock is poised for strong outperformance when operations at its two casinos recommence upon the completion of vaccine rollouts.

A2B Australia (A2B.ASX) detracted as it retraced 4% following COVID-19 outbreaks and lockdowns of various severity and duration in Melbourne, Sydney and some of the minor capitals. We suspect tax-loss selling also played a role in the weakness. With a strongly net cash balance sheet, property holdings that we believe to be worth materially more than the historical cost on the balance sheet and a business with a track record of earning c$20m of EBIT prior to COVID-19 we believe the stock still screens extremely cheaply and is well placed to drive outperformance upon the successful (even if belated) vaccine rollout in Australia.

Outlook & Strategy

We continue to believe that the interests of our investors are best served by staying true to our investment philosophy of buying cash generative business models, with a demonstrated track record of solid returns and at a sensible valuation given their industry dynamics and positioning. While the emergence and spread of variants of COVID-19 with greater transmissibility and in some cases the ability to evade vaccines (especially sterilising immunity as opposed to the prevention of hospitalisation or deaths) is likely to cause volatility, the evidence overseas suggests the current crop of vaccines have firmly broken the once firm link between rising cases and hospitalisations and deaths. We continue to place an informed bet on the ingenuity of humankind to conquer this challenge. The rising specter of inflation and some emerging signs of a reluctance by Central Banks to pump prime to the same extent as they have since the emergence of COVID-19 means we are focusing our efforts on finding business models with pricing power and trying to avoid those that are likely to see unexpected compression in margins (e.g., mining contractors). The market continues to be conducive to high levels of corporate activity given plentiful liquidity, procyclical boards and record levels of private equity dry powder. We anticipate we may be the beneficiaries of future activity given our predilection for undervalued, cash generative businesses with modestly or underleveraged balance sheets. Pleasingly we continue to be presented with opportunities for rotation into new

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names with strong fundamental valuation support as Mr Market's attention waxes and wanes in different names. The market remains highly bifurcated amid concerning signs of speculative excess in concept stocks and those leveraged to popular thematics. We continue to avoid these overvalued names and instead try to maximise the risk reward equation for investors with a disciplined investment approach strongly guided by valuation fundamentals.

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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