# Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

## Performance as at 30th June 2021

| | 1m | 6m | 1yr | 3yr p.a. | Inception p.a.# |
|---|---|---|---|---|---|
| **Fund ^** | **3.2%** | **11.6%** | **43.5%** | **10.5%** | **12.4%** |
| *Benchmark** | *3.4%* | *10.5%* | *34.5%* | *10.6%* | *12.1%* |
| Value added | -0.2% | 1.1% | 9.0% | -0.1% | 0.4% |

^ 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.

## Commentary

The Spheria Opportunities Fund returned 3.2% (after fees) in June, slightly underperforming the benchmark by 0.2%. Over the quarter to the end of June, the Fund rose 5.7%, underperforming the benchmark by 3.6%.

### 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), REA Group (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 modestly underperformed as a retracement in the share price of embattled casino operator Crown (CWN.ASX) outweighed attribution from overweights to small and microcap gaming, media and retail exposures.

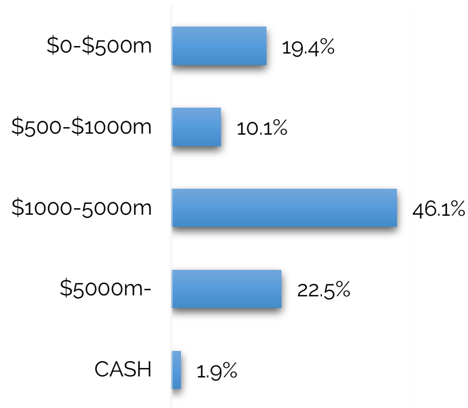
***Continued on the next page….***

## Top 5 Holdings

| Company Name | % Portfolio |
|---|---|
| Orora Limited | 5.5 |
| Als Ltd | 4.9 |
| Incitec Pivot | 4.4 |
| Fletcher Building | 4.3 |
| City Chic Collective | 3.6 |
| **Top 5** | **22.6** |

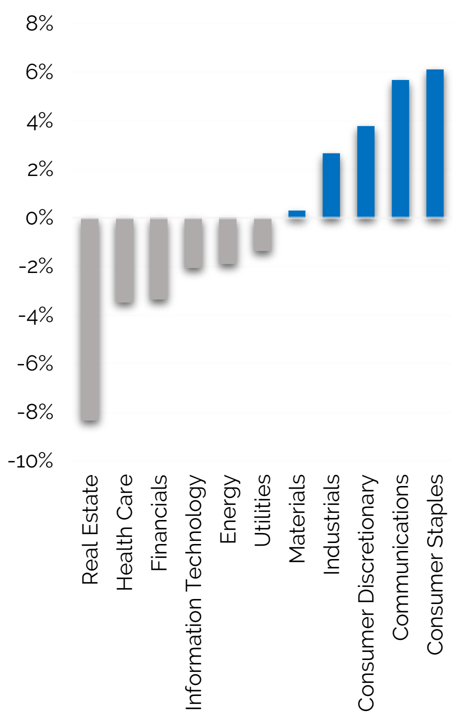
Source: Spheria Asset Management

## Market Cap Bands




Source: Spheria Asset Management

## Active Sector Exposure




Source: Spheria Asset Management

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

**Northern Star Resources (NST.ASX - not owned)** was the largest contributor to attribution as it returned –15.4% before its inclusion in the top 50 index saw it depart the benchmark S&P Mid-Small Accumulation Index. While the business is a quality collection of assets with strong management it has screened too expensively to us for some time hence our nil weighting.

**City Chic Collective (CCX.ASX)** contributed as it returned 17% over the month. The mainly online specialty retailer of plus sized female apparel across three brands in Australia, the US and the UK appears well positioned to benefit from the re-opening that continues to occur in these nations and the significant bounce back in apparel expenditure (depressed by lockdowns in the U.S. and U.K in particular) that is accompanying this trend.

**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 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

Crown Resorts (CWN.ASX) was the largest detractor as it declined 8% on negative newsflow from the Royal Commission being undertaken by Justice Finkelstein in Victoria and modestly disappointing guidance for the 2H21 driven by the recent Melbourne and Perth lockdowns. Whilst it makes for uncomfortable reading, we continue to

***Continued on the next page....***

believe that Crown will ultimately retain its licences albeit potentially with further changes to its board and management being required. With two suitors for the entire company (10% shareholder Blackstone and competitor Star Group (SGR.ASX)) and a proposal from PE firm Oaktree to fund the selective buyback of the problematic holding of major shareholder James Packer we view the discount to intrinsic value as attractive notwithstanding the highly negative sentiment it faces over the next several months.

**Resmed (RMD.ASX - not owned)** detracted as the provider of CPAP machines and masks surged 21% following news of a recall affecting competitor Phillips' first generation DreamStation products. While we believe this development will benefit Resmed we see the firm as excessively valued at 33x FY22 EV/EBIT and 41x FY22 EV/FCF.

**Geopacific Resources (GPR.ASX)** detracted 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.

## 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 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.

# Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

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