Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Performance as at 28th February 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund^	**6.0%**	**38.1%**	**39.5%**	**9.1%**	**13.4%**
*Benchmark**	*1.5%*	*12.1%*	*17.2%*	*7.2%*	*9.7%*
Value added	4.4%	26.0%	22.4%	1.9%	3.7%
*Microcap Index ***	*2.0%*	*23.2%*	*51.5%*	*11.5%*	*13.3%*

^ 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.

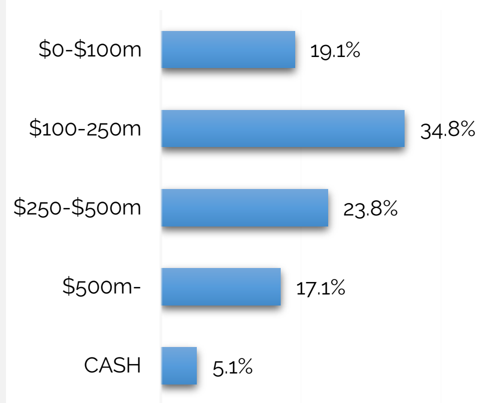
Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Supply Network	4.5
Class	3.9
NZME	3.6
A2B Australia	3.4
Seven West Media	3.3
Top 5	**18.8**

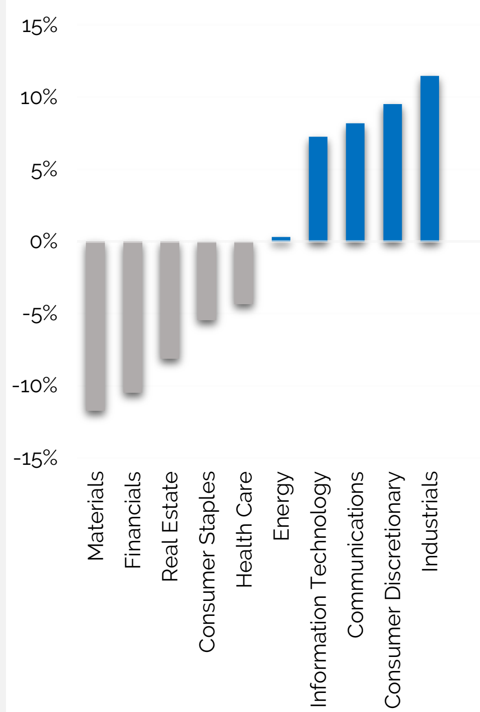
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Commentary

Spheria Australian Microcap Fund returned 6.0% (after fees) in February, outperforming it's benchmark by 4.4%.

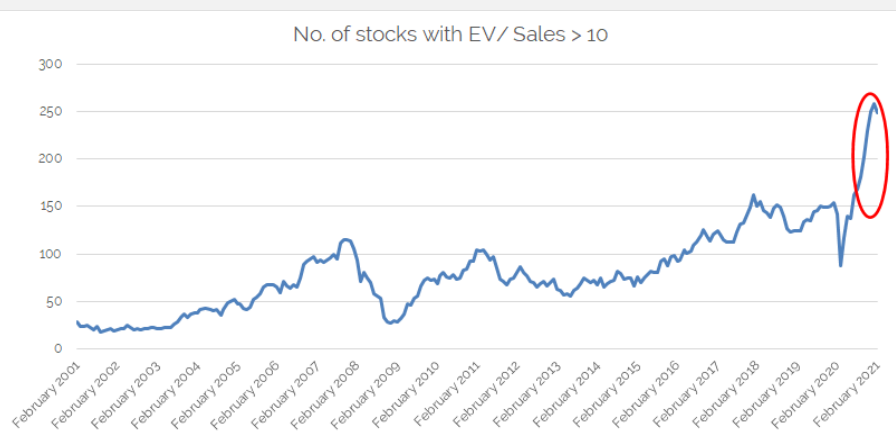
Markets

Markets were higher over the month of February as confidence in a global recovery from the COVID-19 pandemic built with the ongoing rollout of vaccines and amid real world evidence of their efficacy. This manifested itself in higher prices for energy and industrial commodities and related equities. Re-opening trades amongst heavily COVID-19 impacted sectors also tended to perform strongly This confidence was a two-edged sword however as increasingly bullish sentiment on cyclicals saw rising inflation expectations reflected in rapidly rising long term bond rates. This impacted on rate sensitive sectors like REITs, Utilities and some highly valued technology names.

Locally we observed some retrenchment amongst a number of very highly valued names, particularly those that disappointed during the period. Nuix (NXL.ASX, -34%), Kogan (KGN.ASX, -22%), Elmo Software (ELO.ASX, -22%), Temple & Webster (TPW.ASX, -19%), Netwealth (NWL.ASX, -18%), Infomedia (IFM.ASX, -17%), HUB24 (HUB.ASX, -15%) and Electro Optical Systems (EOS.ASX, -14%) for instance demonstrated the risk of buying firms where expectations are sky high.

Despite this retrenchment in some of these momentum names we continue to observe a highly bifurcated market with some very high valuations for names exposed to popular thematics (e.g., battery materials) and names with strong top line growth in the E-Commerce, Fintech and Biotech sectors.

The prevalence of near zero interest rates until very recently has allowed fundamentals to go out the window in the small cap universe locally as the concept of a Cost of Capital became increasingly abstract. We have seen this play out in an increasing number of companies trading on stratospheric revenue multiples as seen in the chart below.



Source: Bloomberg data, ASX stocks with market cap >$50m, <$3.0b and EV/trailing sales multiple >10x.

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Typically, these stocks are exposed to favourable thematics (e.g., electric vehicles) or have a great story to tell about a large total addressable market and a business model that *might* provide investors access to said market (aka a "concept stock"). Needless to say, the vast majority of these firms remain unprofitable.

Major Contributors for the Month:

Seven West Media (SWM.ASX) was the largest contributor to performance during the month returning 51%. Seven West Media reported a result well ahead of market expectations as television advertising returned to growth during the 4Q of calendar 2020, the cost base was better controlled than expected and the balance sheet saw material de-leveraging. The business also announced a collaboration with google that should see a material revenue contribution. Seven continues to have upside from the recent improved ratings share translating into revenue share and potential news flow around the divestment of the studios and/or towers. Despite SWM's strong share price recovery it still trades on a mid-single digit EV/EBIT multiple which is well under its nearest listed peer.

Supply Network (SNL.ASX) contributed to outperformance as it returned 17% on the delivery of yet another strong result (EBIT up 30% all organically). The business which is a leading player in the still highly fragmented distribution market of truck and bus parts has built a record of consistent delivery of 10-15% organic earnings growth at high returns (> 30% ROIC). At a mid-teen EV/EBIT multiple and with a rock-solid balance sheet we expect to continue to see this name outperform the market over the medium term.

Horizon Oil (HZN.ASX) contributed as it returned 24% over the month as the benchmark WTI oil price surged 18% on improved economic activity and continued supply curtailments by OPEC. Horizon continues to screen very well on EV / Reserves and EV/ EBIT multiples relative to other listed oil firms.

Major Detractors for the Month:

ZIP Co (Z1P.ASX – not owned) was the largest detractor as it rose another 43% over the month on the back of a result that revealed very strong US top line growth. ZIP is one of many BNPL competitors yet to go through the inflection point of profitability with accounting profits and cashflows still meaningfully negative. While we appreciate the market opportunity in the U.S. is large, we do not see how ZIP's Quadpay will outcompete the likes of Paypal, Afterpay, Klarna and Affirm who all enjoy a very large lead in customer numbers (both merchants and consumers). We would also note that increasingly these firms are now targeting Z1P's home market of Australia. Paypal for instance just announced the June 2021 launch to its 9 million active Australian account holders of its Pay in 4 service. Incredibly Paypal charge zero additional cost to merchants versus its traditional payments platform which should ensure extremely rapid take-up of the service.

Lynas Rare Earth (LYC.ASX – not owned) detracted as it returned another 25% over the month on the back of increasingly exuberant sentiment towards the EV thematic and how this will impact on prices for Lynas' key permanent magnet rare earth output (neodymium-praseodymium (NdPr) oxide). While we see the likelihood of EV and wind turbine demand continuing to be strong (the key end market for this material) we also note that vehicle and turbine makers are spending considerable funds to reduce and/or eliminate the usage of this material through the use of alternate materials and/or technologies (e.g., low temperature superconducting magnets in the case of turbines, switched reluctance motors in the case of EVs). Further we would note that rare earths are not actually very rare. The massive valuations being ascribed to potential producers is likely to see several raise sufficient capital to move into production over the medium term.

Mortgage Choice (MOC.ASX) was the largest detractor as it returned –10% following a softer than expected result. While the growth of cash NPAT adjusted for one off failed M&A costs was a respectable 7%, this appeared to disappoint expectations given the background of strong growth in mortgage originations seen during the half (c20% year on year). We would note however that this growth was primarily driven by refinancing activity rather than new loans for purchases which dragged on the growth of the mortgage book (which drives trail revenue). The book growth was also hurt by the staggering COVID-19 lift in savings rates which saw loan balances paid down and cash held in offset accounts (trail is paid on net balances outstanding). We would expect greater operating leverage to the strong housing finance growth currently being seen to emerge in the 2H21 as these latter two factors abate. At c8.5x annualised EBIT Mortgage Choice still looks lowly priced given the favourable tailwinds being seen in mortgage finance growth.

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Strategy and Outlook:

We continue to believe valuation discipline is key to the delivery of sustained outperformance over the long term in equity markets. While it is easy to be distracted by investor exuberance towards sectors benefiting from a popular "thematic" we continue to focus on buying cash generative business models, with a track record of solid returns and at sensible valuations. If this sounds a little repetitive it's because the process continues to be unchanged. Pleasingly the volatility induced by the heightened activity of retail, passive and quant investors also continues to present us with opportunities to invest in new names with the characteristics that we are after as "Mr Market" discounts unpopular business models to chase the latest thematic or concept stock. While the lift in bond rates during the month saw some air come out of some of the most highly valued stocks in the market, we continue to observe a bifurcation of the market that remains near historic highs amid concerning signs of speculative excess in momentum names. We believe that remaining disciplined in this environment means we stand a good chance of being rewarded with outperformance in a world where observation of fundamentals appears increasingly rare.

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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
FNZ Group
HUB24
IOOF Pursuit
Macquarie Wrap
mFund
MLC Wrap / Navigator
Netwealth
One Vue
Powerwrap
Praemium
Premium Choice
Wealth O2