Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Performance as at 31st January 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund^	**-0.1%**	**47.9%**	**17.9%**	**6.2%**	**12.3%**
*Benchmark**	*-0.3%*	*18.3%*	*5.4%*	*6.7%*	*9.5%*
Value added	0.1%	29.5%	12.5%	-0.5%	2.8%
*Microcap Index ***	*3.9%*	*38.5%*	*27.6%*	*10.7%*	*13.0%*

^ 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.

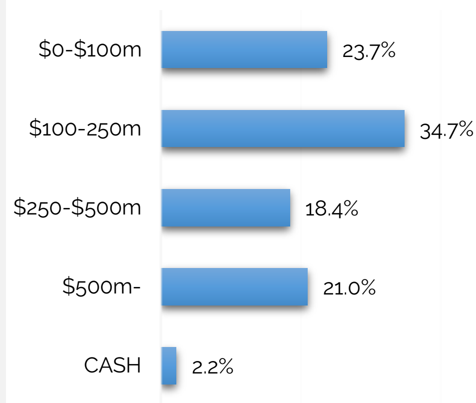
Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Mortgage Choice Ltd	4.5
Supply Network	4.1
Asaleo Care Limited	4.1
Class Limited	3.9
A2B Australia Ltd	3.7
Top 5	**20.3**

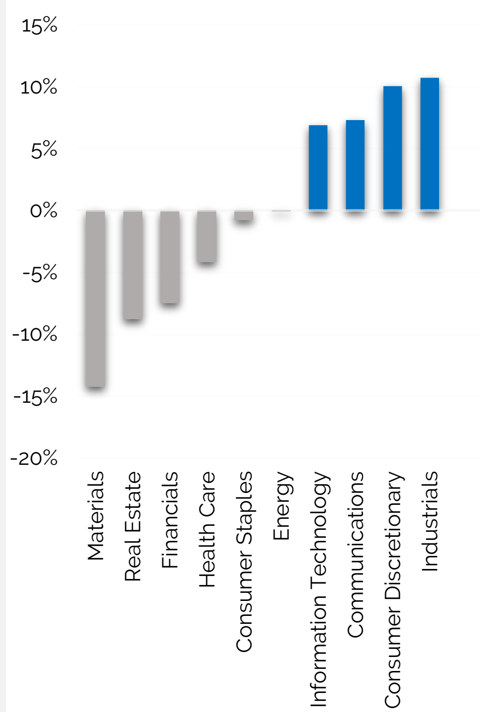
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Commentary

Spheria Australian Microcap Fund returned -0.1% (after fees) in January, marginally outperforming it's benchmark by 0.1%.

Markets

Markets locally were broadly flat in January after a solid increase over the latter half of 2020 including December. January was characterised by some generally positive trading updates from a raft of retailers who continue to see their businesses spurred on by an accommodative economic backdrop and continued crimping of spending in other consumer discretionary areas (namely Tourism and Leisure). The macro environment – despite the uncertainties caused by Covid 19 – is highly supportive of both company earnings (in most sectors) and asset prices. This is likely to continue to lead to upward pressure on stock prices. It is also likely to drive M&A and other corporate activity as we have noted for a while. January did not disappoint here either with a consortium of CPE Capital (formerly Champ Private Equity) and Macquarie Infrastructure and Real Assets (MIRA) emerging for Bingo Industries (BIN.ASX).

Precisely how long we will be in this macro environment is anyone's guess, but the answer appears to boil down to how long Central Bankers can keep playing a double bluff with monetary policy. Whilst there is a lack of the spectre of inflation, effectively printing money remains the key modus operandi of both Central Banks and Governments worldwide. For Governments, this means taking on additional debt comes with little to no (and in some cases negative) cost. Until investors in fixed income come to believe they need higher rates to compensate for long term bond risk, it seems the macro environment is likely to remain extremely accommodative. The alternative is that perhaps the correcting mechanism this time will be social/political as opposed to fiscal or monetary policy. Whilst there has been little consumer price inflation (in the limited way CPI is measured) there certainly has been asset price inflation. This creates additional social divide in a society and could ultimately be the driver of monetary or fiscal reform for example by way of additional taxes.

Major Contributors for the Month

Ainsworth Gaming (AGI.ASX) rose 67% over the month (after returning 52% in December). AGI had not participated at all in more buoyant sentiment towards COVID-19 recovery trades, hitting all-time lows in November 2020.

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Market participants finally began to appreciate that the business has a valuable portfolio of State gaming machine licences in the US and that its solvency is underwritten by land and buildings worth materially more than the historical book value disclosed in the accounts.

Polynovo (PNV.ASX – not held) contributed meaningfully versus the index as it declined 32% over January. PNV provided a sluggish sales update for Q2 2021, with revenue growth showing a substantial slowdown sequentially on their first quarter revenue growth of 75%. PNV remains a very highly rated company and is not cashflow positive making this the type of investment our portfolios typically don't hold.

Shriro Holdings (SHM.ASX) rose 12% over January and finished up the month with another very positive trading update. Having already provided strong guidance in early December, they upgraded this further after very strong sales figures during the final weeks of the year. SHM has been a consistently strong cash generator, has a strongly net cash balance sheet and trades on less than 4x EV/EBIT with a forecast yield of 8%.

Major Detractors for the Month
Mortgage Choice (MOC.ASX) has been a strong recent contributor for the fund but declined 6% on limited news flow over January. MOC is exposed to the rapidly recovering housing finance cycle which is being spurred by the super low interest rates discussed above. With housing finance approvals up 31.2% YoY in December to record levels, MOC is likely to report strong growth in earnings this year and yet trades at an attractive valuation of just 9x EV/EBIT. Current management at MOC has done substantial work to improve the business model and the mortgage broking industry could see further consolidation.

ZIP Co (Z1P.ASX – not owned) rose 37% over the month on the back of a trading update 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).

Lynas Rare Earth (LYC.ASX – not owned) rose 20% over the month on the back of a continued recovery in rare earths prices. Malaysia extended Lynas' current operating license for a further 3 years (albeit with conditions) which removes some short-term risk the market had started to price into the share price. At current valuations, our assessment is that a lot has been priced into the Lynas' share price and we can find better value elsewhere.

Outlook
Smaller capitalisation stocks have traditionally been the market segment most prone to M&A activity. We are beginning to see signs of this re-emerging which has tended to play to the portfolio's strength in the past. Capital is also likely to be released to the market via IPO's and founder sell downs which we see as highly likely over the next year or so. Whilst the backdrop of extremely loose monetary policy has driven some areas of the market to speculative excess, there remain others where valuations and fundamentals are supported by cash flow and valuation.

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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