Performance as at 31st May 2021

	1 Month	3 Months	1 Year	2 Years#	Inception#
Fund^	2.8%	11.0%	42.2%	26.2%	25.1%
*Benchmark**	3.2%	8.8%	65.6%	26.3%	22.6%
Value added	-0.3%	2.2%	-23.5%	-0.1%	2.6%

^ Spheria Global Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes
* Benchmark is the MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net).
# Inception date is 1 March 2019. Returns are per annum.
Past performance is not a reliable indicator of future performance.

The Spheria Global Microcap Fund returned 2.8% after fees during May, lagging the Kokusai Microcap Index (World Ex-Japan), which returned 3.2%. As we alluded to last month, microcaps are likely to continue outperforming larger peers so long as economic growth from a depressed Covid base remains strong. The MSCI World Index rose 1.2% and the MSCI Small Cap Index (ex-Australia) rose 0.7%.

Since inception, the Spheria Global Microcap Fund has returned 25.1% p/a after fees, 2.6% p/a more than the benchmark Kokusai Microcap Index. Over the same time frame the MSCI World Index of large-cap stocks has increased 14.4% p/a, and the MSCI World Small Cap Index (ex-Australia) has increased 13.7% p/a.

Markets

Bitcoin has fallen, oil prices are grinding higher. What a difference a month can make. Bitcoin-exposed microcaps, that have risen to be amongst the largest stocks in our Microcap benchmark, felt the pain from a large fall in the price of cryptocurrencies. Bitcoin fell from US$56,814 at the end of April to $36,691 at the end of May. Riot Blockchain, with a market capitalisation of US$2.5 billion fell from $41.83 to $27.13. Marathon Digital, with a similar market capitalisation fell from $36.78 to $24.77.

For the record, we are not Bitcoin experts, but based on our current view of the asset class if any of the Fund's holdings invested in Bitcoin or started accepting payment in bitcoin, we would immediately write down the value of the Bitcoin "asset" to zero, and management would have to provide us with an exemplary explanation to stop us exiting the position.

The other dramatic shift in markets is an evident change in signalling by some US Federal Reserve officials (some non-voting) in the media. We are generally nonchalant about the central bank cartel because they have little impact on the long-term fundamental valuation of our investments. However, US Fed Officials are clearly telling the market they are thinking-about-thinking-about tapering, as to avoid a repeat of the 2013

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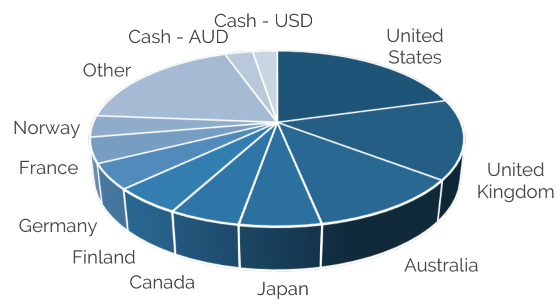
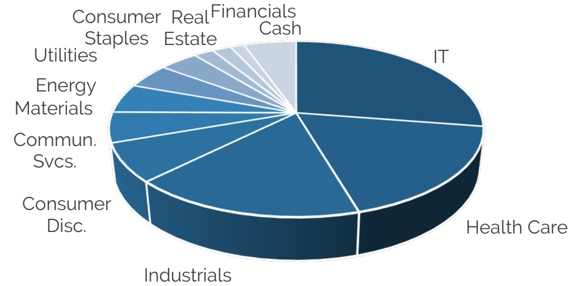
Top 5 Holdings

Company Name	% Portfolio
Fjordkraft (Norway)	4.0%
Poletowin (Japan)	3.1%
Steelcase (USA)	3.1%
Inogen (USA)	3.1%
Somero (UK)	2.8%
Top 5	**16.1%**

Regional Exposure



Sector Exposure

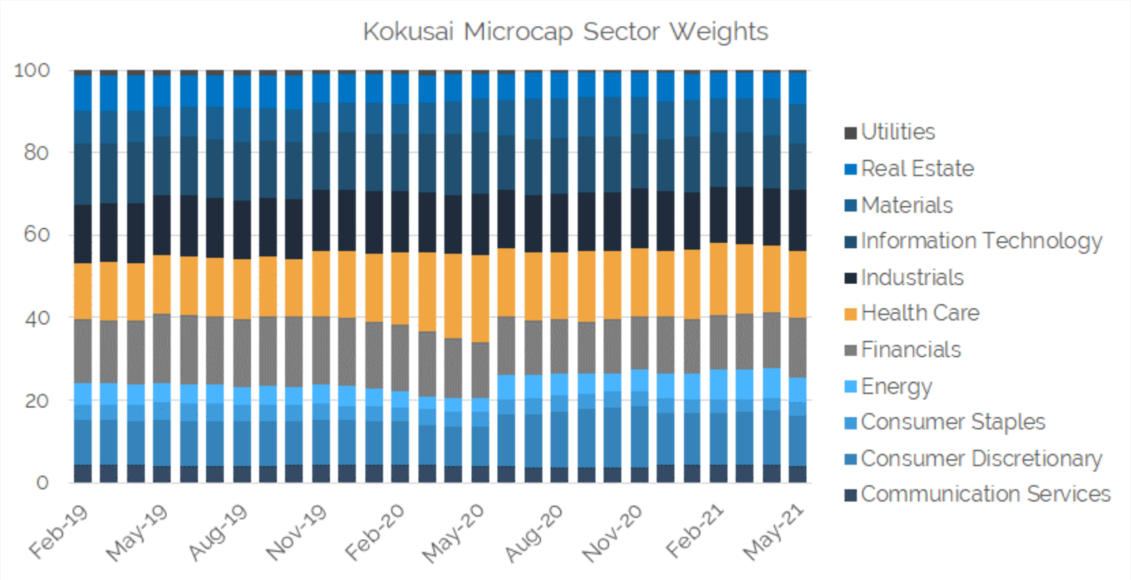


Source: Spheria Asset Management

taper tantrum by markets. This is the strongest language we could expect from the Fed which is fixated on remaining equity market friendly. After all, who do you think pays for all those speaking events once they retire from their Fed positions? Despite these obvious hints, US bond yields did not budge in May. Perhaps the warnings are falling on deaf ears. More likely, bonds have already moved and the market is well ahead of the Fed as per usual.

In microcaps, Energy was the best performing sector in May, up 12.6% in AUD. There is little doubt that Energy has been impacted as much by sentiment as low oil prices. Talk of industrial electrification and a rapid move to electric vehicles has seen sound-bite investors shun the sector. However, oil prices are at a three year high as transport, the most significant use of petroleum, increases in the US with its rapid vaccination roll-out. The Fund does not currently own a pure energy asset owner, but rather two service companies that help energy companies optimise their assets. These companies are likely to show leverage to any oil recovery, but possess strong intellectual property and operate in a far more attractive industry structure than the asset owners themselves. Both our holdings remain attractive despite recent performance.

As the chart below shows, Healthcare is again the largest sector in the benchmark. Microcap healthcare is one of the few sectors that trade at a premium to large-cap sector peers. Microcap healthcare stocks trade at 21.2 EV/EBIT compared to large-cap healthcare names at 19.9x (S&P500). These relatively rich valuations in Healthcare have prevented us from having an overweight position in the sector.



Source: MSCI

However, more recently, we have added several new healthcare names that appear to offer excellent undiscovered value. Especially when we take their growth rates into consideration. Large-cap pharmaceuticals are considered high growth if they manage to surpass mid-single-digit growth rates. The Spheria Global Microcap Fund's ten healthcare stocks have a weighted average EPS growth rate of 116%. As we highlight time and again, it is hard to trump the growth that these smaller companies can generate from a low base.

At a country level, Norway, Denmark & Australia were the laggards, while Italy, Canada and Germany led the benchmark higher. Investors may be drawing optimism from the instalment of "Whatever it Takes" Mario Draghi as Italian Prime Minister. It's not the first time Italians have turned to a technocrat to try and fix their malaise, but Draghi has impressed with his early rhetoric. Draghi has announced plans to spend a large part of Europe's €750bn Covid recovery package on infrastructure, environmental initiatives, digitisation, and steps to close the gender pay gap in Italy.

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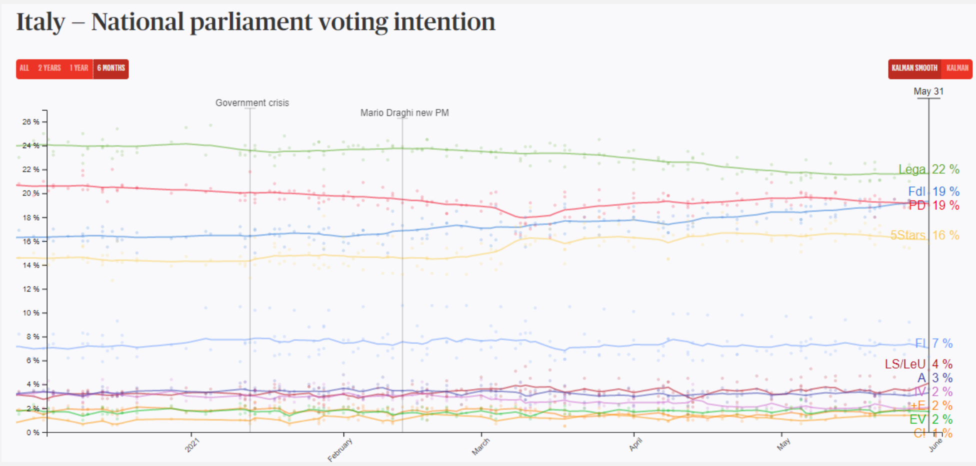
However, given Italy's fractured political system, whether Draghi will be afforded the time to follow through remains to be seen. Alarmingly, recent polls show a rapid ascendency by the party called Brothers of Italy (FdI 19% - top blue line in the chart below), a right-wing party with strong support from neo-fascist groups. The demise of Trump does not guarantee a widespread return to moderate Governments.



Source: Politico

Fund Performance

<u>Core Laboratories</u>

The Fund's top-performing position in May was Core Laboratories (CLB.US).

Core Laboratories is the leading provider of oil reservoir optimisation services. Its two primary services encompass reservoir description & production enhancement. Because the company's services focus on production rather than exploration, demand from its customers is relatively stable. Core Laboratories also focuses on differentiated offerings rather than generic services, and patents and proprietary technology protect these. As a result, it has historically displayed industry leading margins and returns.

Source: Core Laboratories

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The company's metrics have been historically strong, with attractive free cash flow (99% free cash flow conversion) and returns. This performance is no surprise given management's three financial tenets shown below.

- Maximise Free Cash Flow
- Maximise Return on Invested Capital
- Return Excess Capital to Our Shareholders

The Fund purchased Core Laboratories in November 2020. The company has been listed since the mid-90s, but with the decline in oil prices caused by Saudi Arabia's move to flood the market and Covid, Core Laboratories had seen better days. Its market capitalisation had declined to under US$700 million when we began our due diligence, from a high of US$9.7 billion in 2014.

In assessing Core Laboratories, Spheria's mid-cycle valuation process came to the fore. We recognised that this high-quality oil services company was priced well below a valuation that reflected mid-cycle earnings. While our investments are typically formed on a 3-5 year view, as is often the case, we were rewarded sooner than expected. As oil prices have settled and recently recovered, earnings momentum has improved, which has seen the share price recover from our entry price below US$20 to the current share price of over US$40.

Fjordkraft

Fjordkraft (FKRFT.NO) was the Fund's largest detractor in May.

Fjordkraft continues to suffer from poor investor sentiment, sparked by a negative broker research report. The market's key concerns regarding Fjordkraft are:

- Increased scrutiny from consumers and Norway's Consumer Council around contract disclosure.
- Competition from smaller players offering short-term switching incentives that large players have been forced to match to defend their market share.
- An equity raising overhang caused by speculation that Fjordkraft may raise equity to buy some of the assets a competitor's parent has flagged for sale.

The sharp rebound in energy prices during a period of increased scrutiny has not been helpful for the company. Pressure to absorb the price increases have only sought to stoke fears about margin degradation. However, in our experience, such negative sentiment often provides excellent opportunities to buy high-quality companies such as Fjordkraft. We see all these issues as transitory.

The industry as a whole is addressing concerns around electricity price disclosure by agreeing to a new certification process, of which Fjordkraft will be one of the first to comply. Fjordkraft continues to be the beneficiary of regulatory changes splitting asset-owning operations from retailing. This is resulting in a myriad of new sub-scale businesses operating at a significant cost disadvantage to larger retailers such as Fjordkraft.

Competitive pressure is not new, and despite the market's hysteria around margin pressure, it is interesting to note that the company's recent move into Sweden and Finland has shown margins are higher in those markets.

Nevertheless, on our analysis, the share price now implies Fjordkraft's margins halve. The company trades on a consensus FY21 P/E of 13x and dividend yield of 6.5%. Meanwhile, EPS is forecast to grow from 3.69 in FY20 to 5.46 by FY23, or growth of 14% p/a.

Our thesis remains that regulatory changes and consolidation by Fjordkraft will improve the industry structure and help maintain margins above expectations. Significant back-office synergies from expected future acquisitions further aid this.

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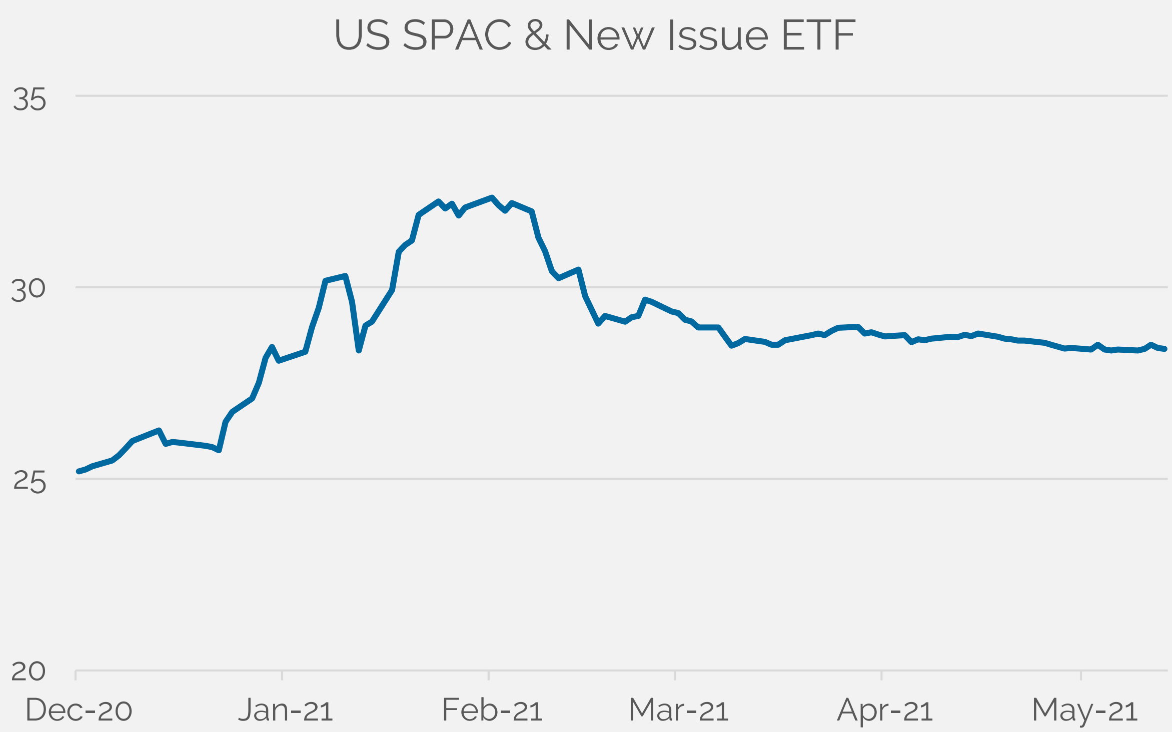
Outlook

“People are strange when you’re a stranger”. The Doors’ Jim Morrison may have used some unorthodox inspiration for his lyrics, but increasingly they have been resonating with us. We do feel strange, focusing on valuation when earnings momentum, nay, revenue momentum seems to be the only factor considered by the market. We feel strange focusing on fundamental research when the simple mention of a thematic such as Bitcoin can attract nosebleed market capitalisations.

Fortunately, it feels like our days of feeling strange may be coming to an end. There are some signs that we may be about to “Break on Through to the Other Side”.

Special Purpose Acquisition Companies, or SPACs, are a blank cheque written to star executives and celebrities guaranteeing large fees for them and their friendly neighbourhood investment bank. However, investors face an uncertain and risky path merely to recoup the upfront fees. Only very high levels of greed would entice investors to participate in such rigged structures, and of late, there has been a retracement in SPACs as measured by the SPAC Index below.



Source: Bloomberg – SPCX Index

Bitcoin, perhaps unparalleled as an arena for rampant speculation has fallen from its highs. An instrument such as this with no claim to future cash flows, no industrial uses, and no regulation, provides the perfect barometer for investor fear and greed.

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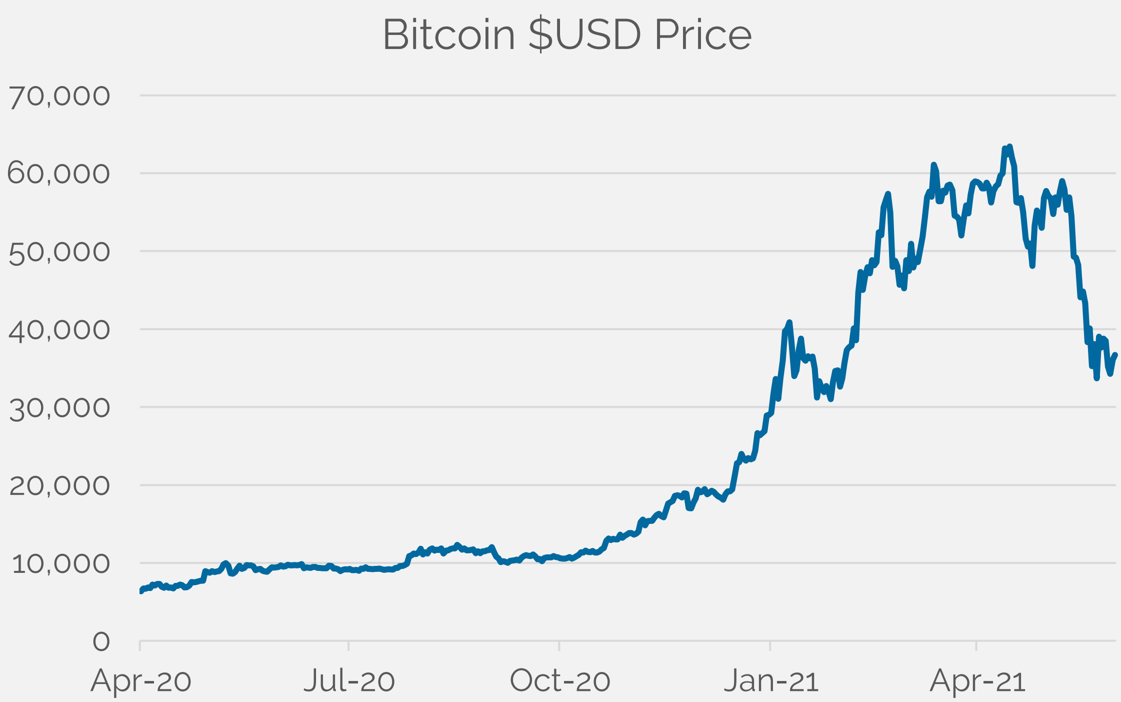
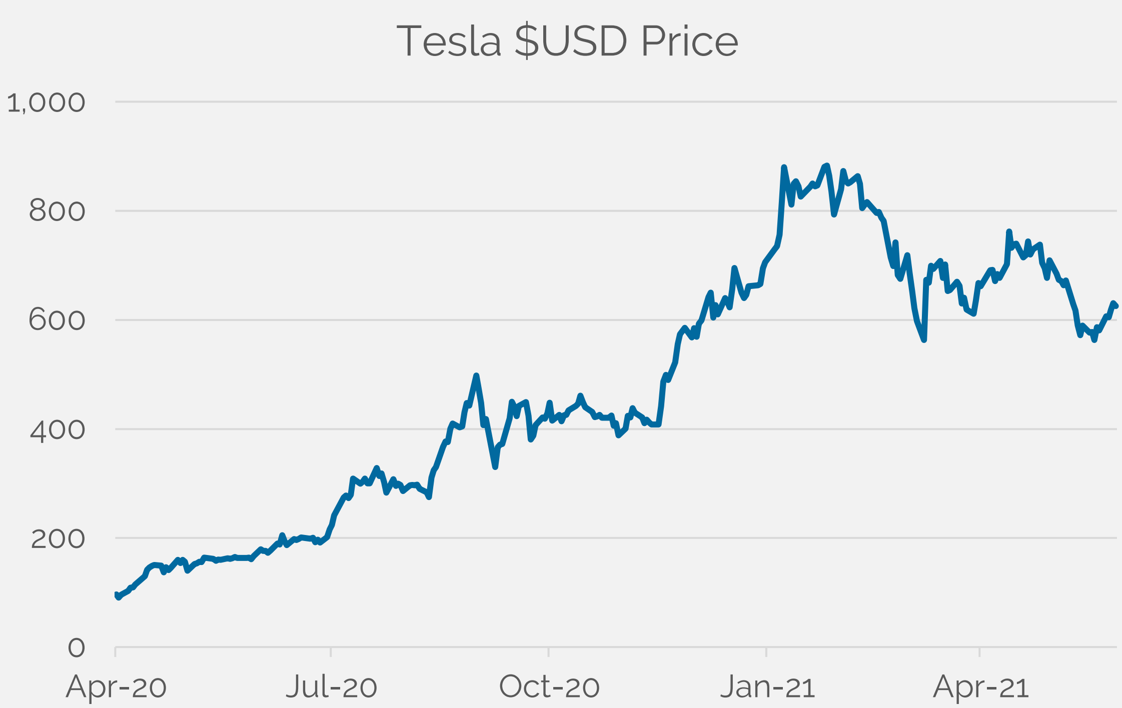


Source: Bloomberg

Tesla, so absurdly priced that almost every reputable hedge fund manager in the world has tried to short the stock at one time or another, has finally retraced some of its gains. Tesla could almost be considered a value stock now that its value is almost equivalent to Toyota (ignoring the US$20bn p.a. gap in net income).



Source: Bloomberg

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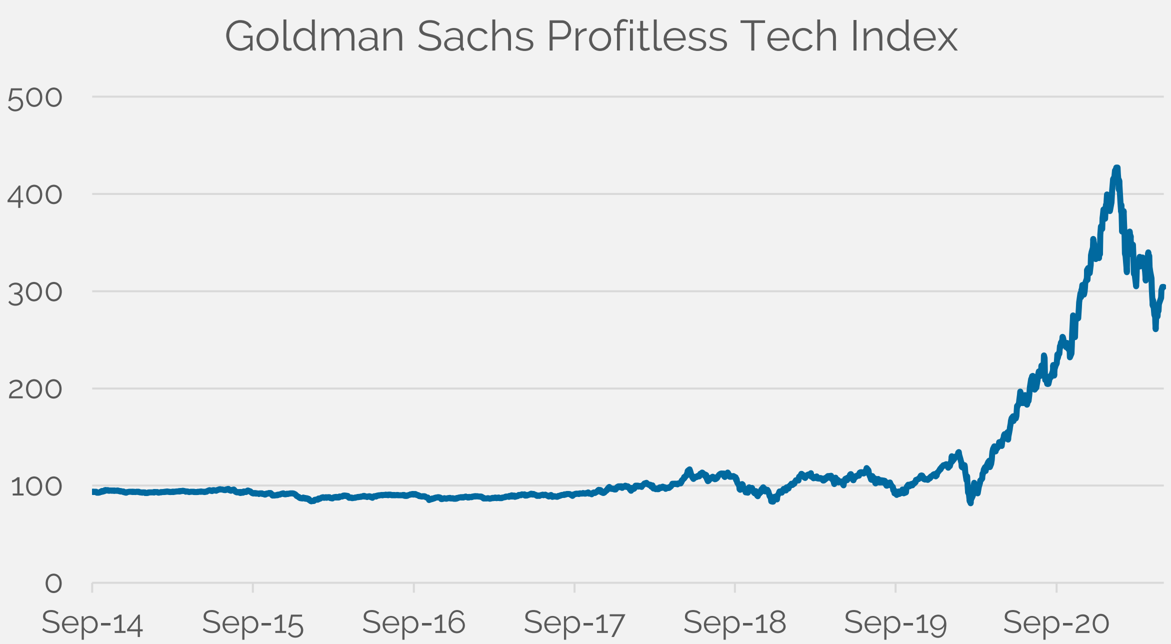
And finally, on our wall of shame, the Goldman Sachs Profitless Tech Index. This measure of profitless technology stocks weighted to maximise liquidity is well off its extreme highs. However, much to our chagrin, the Index staged somewhat of a comeback in May.



Source: *Bloomberg*

Combined, this is a clear signal that not all is well for these strangers that now inhabit the market.

However, Spheria's portfolio is showing no such fatigue with unit prices ending May near their highs. The difference is, the Fund's investments are backed by a stream of predictable free cash flow that accrue to equity owners and are paid as dividends. This means that our Fund's investors are set to do well "When the Music's Over", unlike the strangers.

Spheria Global Microcap Fund

ARSN 627 330 287 APIR WHT6704AU

	Spheria Global Microcap Fund
Benchmark (universe)	MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net)
Investment objective	The Fund aims to outperform the MSCI Kokusai (World ex Japan) Microcap Index in AUD (Net) over the long term.
Investing universe	Global listed microcap equities predominantly in developed markets with a market capitalisation of US$1.0bn and below at time of purchase.
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
Expected turnover	20%-40%
Style	Long only
APIR	WHT6704AU
Minimum Initial Investment	$25,000

Platform availability
HUB24
Macquarie Wrap
Praemium