Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

Performance as at 31st December 2020

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	**4.2%**	**28.6%**	**8.9%**	**8.5%**	**11.1%**
*Benchmark**	*3.1%*	*21.7%*	*13.4%*	*8.2%*	*11.0%*
Value added	1.1%	6.9%	-4.5%	0.2%	0.2%

^ 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.

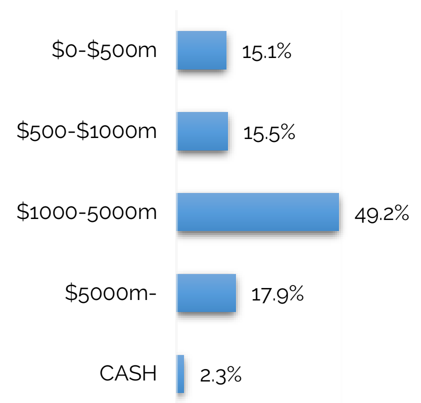
\# Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance.

Top 5 Holdings

Company Name	% Portfolio
Als Ltd	4.6
Orora Limited	4.5
City Chic Collective	4.0
Asaleo Care Limited	4.0
Crown Resorts Ltd	3.8
Top 5	**20.9**

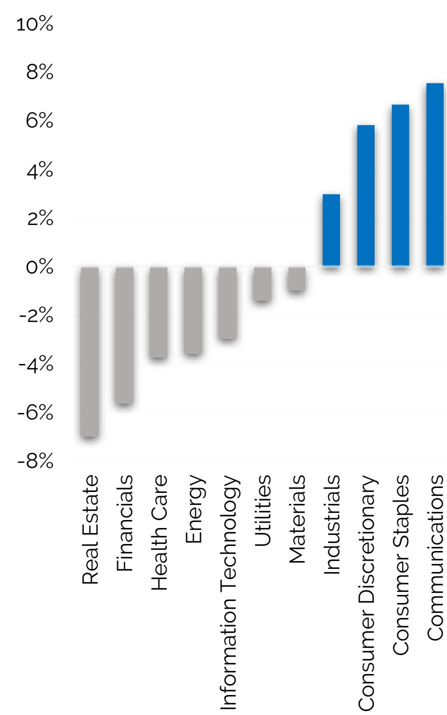
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Commentary

Spheria Opportunities Fund returned 4.2% (after fees) in December, outperforming it's benchmark by 1.1%.

Markets

Markets locally rose over December as strong returns in materials and a narrow grouping of high momentum tech stocks more than offset declines in "re-opening" trades, healthcare and a smattering of stocks that downgraded earnings. Materials performed strongly as iron ore prices reached highs not seen since 2011, Copper reached record high levels in $A terms and lithium prices rose off the canvas helping to supercharge already sky-high sentiment towards lithium stocks following Biden's election to the U.S. Presidency. Multiple tech stocks made record absolute highs and re-rated to record EV/Sales multiples. These included APT.asx and XRO.asx following their graduation to the top 20 and 50 respectively, REA.asx, NAN.asx, and PNV.asx.

Following strong returns in November most "re-opening" trades saw decent price weakness over December as the emergence of the B117 mutant strain in the U.K. added to concerns about rising case numbers in many northern hemisphere nations as they entered their winter. Locally we observed some strong negative share price reactions to downgrades or other negative news with A2M.asx, APX.asx, QBE.asx, AGL.asx, and IRI.asx downgrading guidance during the month. MSB.asx plummeted 46% on the early termination of their COVID-19 trial by the data safety monitoring board due to futility while SSM.asx fell 20% on a smaller than expected revised NBN contract.

The Fund outperformed due to an overweight to media and other cyclicals, a significant re-rating in City-Chic Collective (CCX.asx), the receipt of a takeover offer for portfolio holding Asaleo Care (AHY.asx) and underweights to some of the larger index detractors.

Despite our recent outperformance we continue to observe and remain concerned about speculative excess in high momentum names. This is particularly so in areas that are viewed as COVID-19 beneficiaries like e-Commerce, Fintech and Biotech, but also in our view has more recently extended to certain areas of the materials space. Market participants appear to be all too willing to extrapolate current trends 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.

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Iron ore and iron ore equities for instance appear to be extrapolating strong prices into the medium term following the recent strength caused by higher-than-expected steel production in China (off the back of COVID-19 related stimulus) and somewhat weaker than expected Brazilian supply. This is despite Chinese authorities now actively cooling the white hot property market (accounts for 30-40% of finished steel demand) and the recent announcement of a raft of actions proposed by the Chinese Ministry of Industry and Information Technology to pressure iron ore prices in the medium term including the development of electric arc furnace capacity, the encouragement of new sources of iron ore capacity (particularly outside of the existing producers) and the encouragement of industry consolidation. Market participants also appear to be turning a blind eye to the rapid re-entry of marginal iron ore capacity moth-balled during the downturn and the impacts of material expansions announced by major players (e.g., Champion Iron (CIA.asx) is doubling capacity, Mineral Resources (MIN.asx) is targeting 92m tonnes in 3 to 5 years from 15m tonnes currently).

The stupendous returns out of lithium exposures recently also appears to be a case in point of over-extrapolation. Incredibly, the recent strength has seen the combined market capitalisation of PLS.asx, ORE.asx and GXY.asx trade 22% higher than the peak of the lithium bubble in 2018 despite the price of Lithium Spodumene concentrate being only about half of the then prevailing price and a massive proportion of the industry continuing to operate at a mere fraction of nameplate capacity. While we have no doubt that demand for lithium will grow strongly with the rise of battery electric vehicles, the industry has shown that there is no shortage of projects ready to enter production in a relatively short time frame and the small size of the industry can easily see this swamp new demand. Further, the tremendous market capitalisations ascribed to second and third tier lithium producers imply medium term prices that are well above the level that is required to incentivise the construction of new supply, let alone that required to see existing mothballed capacity restart.

Cobalt is a terrific example of the dangers of overextrapolation. During 2017 and early 2018 Cobalt was seen as the star battery material on forecasts of rampant demand from the growth of the then prevailing lithium-ion battery chemistries. This saw Cobalt triple from its 5-year average and many billions of market capitalisation ascribed to Cobalt mining hopefuls. Unsurprisingly however technological innovation has seen the development of batteries that use far less (or no) Cobalt. The metal now trades 63% below its peak and the mining hopefuls remain > 80% below their 2018 peaks.

Given the significant rise of passive, quantitative and direct retail investors in the market 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 continue to try to ignore the noise and weight the portfolio towards more 'boring' and relatively unpopular names with proven, high returning and cash generative business models that remain at multiples below their historical relative trading ranges.

Major contributors for the month:

City Chic Collective (CCX.ASX) was the largest contributor returning 46% over the month after it acquired the E-Commerce and wholesale operations of UK plus sized fashion retailer Evans from bankrupt retailer Arcadia Group for A$41m in cash. While the deal is at a higher implicit multiple than the Catherine's plus sized fashion acquisition that fell over in September, we believe it is a better strategic fit given it will help City Chic accelerate its organic rollout of the City Chic brand in the UK and Europe and won't see City Chic acquire a brand that already crosses over with an existing portfolio holding.

Seven West Media (SWM.ASX) was the next largest contributor given the company's 29% return over the month. This followed a strong November performance off the back of a better-than-expected AGM trading update and sees the company 100% higher than end October levels and 200% higher than end September levels. Despite this the company continues to screen cheaply. While the balance sheet remains somewhat stretched, we see scope for this to be rectified in the near term through asset sales at materially higher implied multiples than the group trades on.

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Asaleo Care (AHY.ASX) contributed positively as it returned 35% upon the receipt of an unsolicited proposal from its 36% major owner Essity AB of Sweden to acquire all the shares in the company it does not own. We believe the offer of $1.26 is opportunistic and inadequate, given Essity will benefit from synergies with putting its 100% owned Australian healthcare distribution operations together with Asaleo's B2B incontinence care operations. Other holders appear to concur as the company closed the month at $1.35. At the current price the firm trades on 14x forward EBIT, which does not appear egregious for a business that has returned to solid top line growth following a period of significant re-investment in marketing and new product development.

Major detractors for the month:

Afterpay (APT.ASX – Not Owned) was the largest detractor as the stock surged 17% before exiting the S&P/ASX Mid Small Index upon its graduation into the S&P/ASX 20. In early December the RBA decided to not stop BNPL operators who currently ban merchants surcharging end clients to recover the merchant charges levied by BNPL providers. This is in direct contrast to credit card providers who cannot stop merchants recovering the cost of using a credit card from their customers. So long as this decision stands it allows the proliferation of Australian BNPL services to continue to be free to users who pay on time as they are effectively being subsidised by merchant prices that are higher than they otherwise would be for consumers using other more efficient payment services. The combination of this risk being pushed into the background and the promotion of the stock to Australia's pre-eminent equity index boosted the already very strong market enthusiasm for the company. While we admire the staggering paper wealth that has been created in a mere matter of years since Afterpay's founding, we question the sustainability of Afterpay's sky-high Price/Sales (> 33x FY21) and Price/Book (>30x) ratios given the very limited barriers to entry in the space (e.g. key US competitor Affirm is reportedly close to listing on the NASDAQ and raising US$1bn in fresh capital in the process).

A2B Australia (A2B.ASX) detracted as it retraced 15% following a very strong performance over November. No doubt the Northern Beaches COVID-19 outbreak later in the month dented sentiment towards the business given reduced taxi usage from renewed COVID-19 restrictions for hospitality venues. While the company's short-term performance in its core mobility business is likely to remain patchy the balance sheet is more than strong enough to see A2B through ($24m net cash). The company has also begun to articulate a measured strategy to grow its payments business into the non-taxi space in Australia and its mobility platform solutions business globally. We believe the market continues to discount an overly bearish outcome on the core mobility business let alone any success on the latter two growth opportunities.

Flight Centre (FLT.ASX) detracted as the stock retraced 7% following it returning 52% in November due to the release of the highly positive vaccine results from Pfizer and Moderna. The acceleration of the COVID-19 pandemics in North America and Europe over December appeared to dent confidence, particularly new travel restrictions from the UK imposed by other nations who wish to restrict the spread of the more infectious B117 mutation that emerged in the UK. While activity in Flight Centre's European and US business is likely to suffer somewhat as a result (noting that the vast majority of current activity is intra Europe / US domestic) we see Flight Centre's balance sheet as more than strong enough to absorb the expected cash burn until vaccines are widely available later in the year (noting the firm recently raised an additional $400m of capital by way of a convertible). Without meaning to make light of the situation these mutant variants do also have the silver lining of putting significant pressure on governments globally to accelerate vaccine rollout timelines, and hence returning to some semblance of normality. We still see Flight Centre as strongly placed to emerge from the pandemic in a sound financial position and see material share price upside from current levels given the significant reduction in fixed costs the firm has undertaken, particularly in its formerly bloated leisure travel business.

Outlook:

At the risk of boring the reader we are staying true to our investment philosophy to buy cash generative business models, with a track record of solid returns and at sensible valuations having regard to their industry dynamics and positioning. The month pleasingly saw yet more belated recognition of the undervaluation of our portfolio companies. However, we continue to see strong upside on an aggregate basis in our portfolio holdings.

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We also continue to be presented with opportunities for rotation into new names with strong fundamental valuation support. The market remains highly bifurcated amid concerning signs of speculative excess in momentum names. Rather than bemoan the market however we continue to try to optimise the risk reward equation for investors with a disciplined investment approach strongly guided by valuation fundamentals.

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Spheria ASSET MANAGEMENT

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