Spheria Australian Smaller Companies Fund

ARSN 117 083 762 APIR WHT0008AU

Spheria ASSET MANAGEMENT

Performance as at 28th February 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	**4.2%**	**26.1%**	**30.2%**	**9.0%**	**11.4%**
*Benchmark**	*1.5%*	*12.1%*	*17.2%*	*7.2%*	*8.9%*
Value added	2.7%	14.1%	13.0%	1.8%	2.5%

^ Spheria Australian Smaller Companies Fund. Returns of the Fund are net of applicable fees, costs and taxes.

* Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2005. Past performance is not a reliable indicator of future performance.

Commentary

Spheria Australian Smaller Companies Fund returned 4.2% (after fees) in February, outperforming it's benchmark by 2.7%.

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.

No. of stocks with EV/ Sales > 10

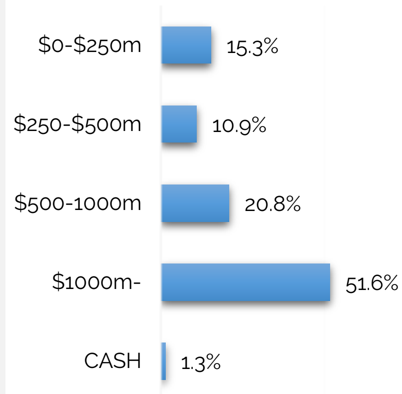
Source: Bloomberg data. ASX stocks with market cap >$50m, <$3.0b and EV/trailing sales multiple >10x.

Top 5 Holdings

Company Name	% Portfolio
Fletcher Building	4.5
Seven West Media	4.3
Healius	3.7
Ht&E	3.6
Blackmores	3.6
Top 5	**19.6**

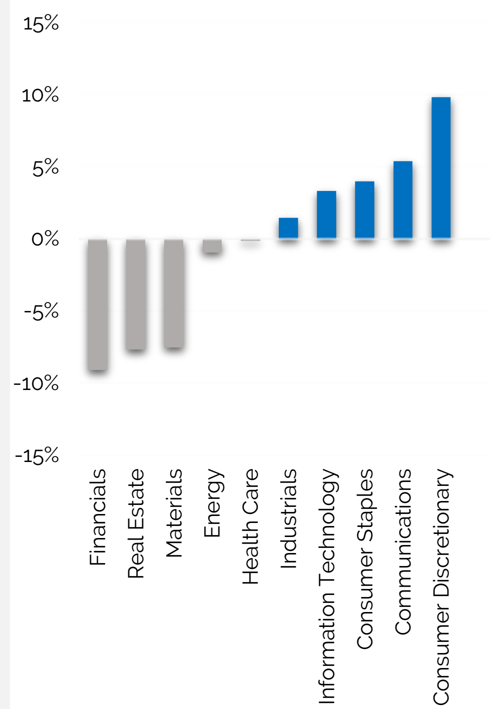
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

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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. In spite of 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.

Corporate Travel Management (CTD.ASX) contributed positively returning 22% over the month. The business posted a respectable result in the circumstances keeping cash burn to a minimum while reporting strong growth in corporate travel accounts. Corporate Travel Management also executed on a transformational acquisition during the half at a very modest multiple on a through the cycle basis. We believe the business is very well placed to return to robust profitability once the western world emerges from travel restrictions imposed due to the pandemic. Importantly the balance sheet is robust with many, many months of liquidity runway at the current modest cash burn levels.

Vista Group (VGL.ASX) added to performance after rising 21% over the month. Vista dominates the market for software into the global cinema exhibition, distribution and production markets. Unsurprisingly the pandemic has had a highly detrimental impact on short term trading as a very significant percentage of global cinema circuits were closed given the social distancing measures by Governments. Despite this Vista managed to keep cash burn to a very modest level. The business has circa 20 months of liquidity runway ahead of it at current burn rates which should significantly improve as the rollout of vaccines in its key market (North America and Europe / UK) see the gradual re-opening of circuits and the release of film content that has been shifted to the right since the pandemic. We see Vista as well placed to return to strong levels of profitability as the pandemic ebbs. At c2.5x historical revenue we also see the business as strongly undervalued on a through the cycle basis.

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).

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.

Class (CL1.ASX) dragged on returns as the stock returned –8% over the month. Class purchased Reckon Docs off Reckon Ltd (RKN.ASX) to further build on its position in the documents and corporate compliance space. Despite meaningful accretion from the deal the market appeared to dislike the fact Class' core super product had relatively flat subscriber numbers during the period. We remain comfortable that Class' management team has built a platform for solid earnings growth with the launch of the new adjacent Class Trust product and the entry into the documents and corporate compliance space. At circa 3.3x revenue and 13x EV/EBIT (annualised 12m forward) for a growing and solidly profitable cloud software business we believe Class remains significantly undervalued.

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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 Smaller Companies 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 100 ASX listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Distributions	Half yearly
Fees	1.10% 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	30-40%
Style	Long only
APIR	WHT0008AU
Minimum Investment	$25,000

Platform availability
Adminis
Aegis
AMP North
ASGARD
BT Panorama
BT Wrap
First Wrap
FNZ Group
HUB 24
IOOF Pursuit
IOOF Wrap
Macquarie Wrap
Mason Stevens
mFund
MLC Wrap / Navigator
Netwealth
One Vue
Powerwrap
Praemium
Premium Choice
Wealth O2