

Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU



Performance as at 31st August 2019

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund[^]	-0.9%	3.9%	-3.3%	6.6%	10.0%
Benchmark*	-3.9%	4.1%	0.9%	8.4%	9.8%
Value added	2.9%	-0.2%	-4.3%	-1.8%	0.2%
Microcap Index **	-0.7%	17.2%	7.0%	5.6%	8.8%

[^] 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
GBST Holdings..	6.9
City Chic Collective	5.2
Mortgage Choice Ltd	4.7
Ht&E Limited	4.4
Class Limited	4.1
Top 5	25.4

Source: Spheria Asset Management

Commentary

The Spheria Australian Microcap Fund declined 0.9% for the month, outperforming the Benchmark which declined 3.9% by 2.9%.

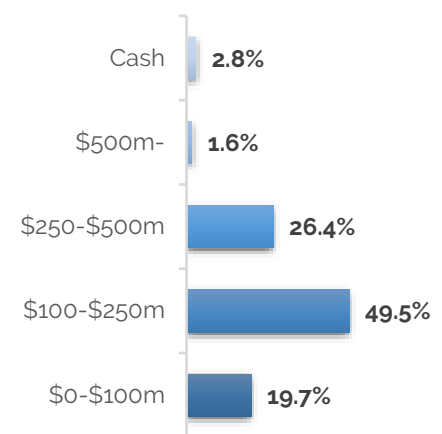
The small cap index fell nearly 4% in August driven primarily by macro-economic factors rather than reporting season per se. Weight of money continued to bolster the insane valuations of fashionable stocks that spin a good story even when their fundamentals are unappealing. In our opinion this is possibly the most inefficient market we have witnessed since the dot-com boom that culminated in the crash of March 2000. The following years were a halcyon period for value managers that survived the relentless march of the momentum tech zealots preceding that bust. Regrettably we see more and more parallels between then and now. We can only hope that the market participants cheering this mania along today are simply a genuinely optimistic lot, rather than displaying the type of behaviour that saw Henry Blodget become infamous post the dot-com bust.

As a fundamentally based investor (i.e. we value securities and invest accordingly) it was comforting to read a news article about Michael Burry - who made a fortune betting against mortgage securities before the 2008 crisis, a trade immortalised in the "The Big Short" - extolling the virtues of smaller value stocks that are being unduly neglected around the world. Like us and other active managers he sees another contrarian opportunity emerging from what he calls the "bubble" in passive investment. As money pours into exchange-traded funds (ETFs) and other index-tracking products that skew toward big companies.

"The bubble in passive investing through ETFs and index funds as well as the trend to very large size among asset managers has orphaned smaller value-type securities globally," Burry said in an email to Bloomberg News. Our strategies are heavily skewed to small/micro-cap value and this has detracted from performance in recent periods. However, like Michael Burry we believe this is where the opportunity is but only the minority will take advantage of this situation given the closure of many value based small cap managers in Australia over the last six months. In our view, money is made by the minority and mediocrity awaits the majority. It's an unfortunate conclusion but a shakeout seems likely with passive strategies the most obvious loser.

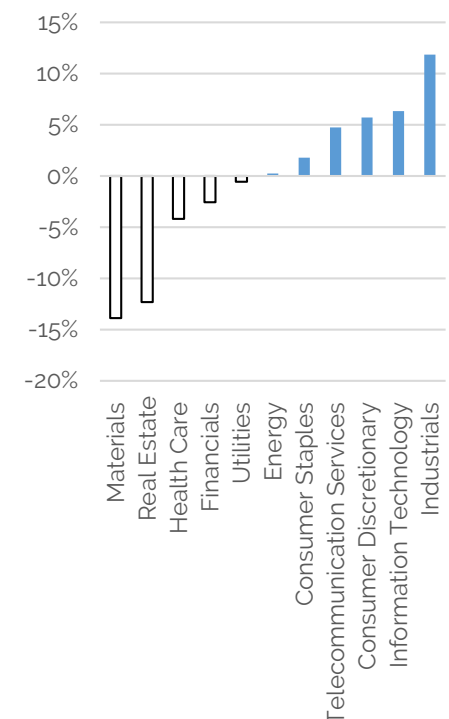
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Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Major positive movers in the portfolio (August reporting period)

Geopacific Resources (GPR) – jumped 71% in August on the back of a rising gold price and the completion of the Independent Technical Experts report on the Woodlark project, allowing the next stage of financing to commence. This will allow GPR to advance discussions with interested lenders, to work towards a complete financing solution that will involve an equity raising. GR Engineering (GNG) has recently been awarded the EPC contract to build the 2.4m tonne pa CIL processing plant and other supporting infrastructure. All-in sustaining costs for the first 5 years of operation are expected to be A\$866/oz at a grade over 1.5g/t. The low-cost nature of the project provides a significant margin of safety in the event of a falling gold price environment.

Isentia (ISD) – bounced 31% in August after reporting a solid result with earnings stabilising, strong free cash flow, debt reduction and emerging signs of a turnaround in the core Australian business. The new CEO has just ticked over a year but has clearly made major strides on technology innovation, sales productivity, reducing churn and importantly culture. The interim copyright licence allowing it to compete on a more even playing field but also providing capital to invest back into technology and cost efficiencies. The company looks screamingly cheap at 7x free cash flow, particularly if the company can begin to grow earnings in FY21 and beyond.

Wellcom (WLL) – leapt 29% in August after surprise takeover offer at 28% premium to its closing share price that day. Whilst a nice short-term lift for the fund we were disappointed to lose a well-managed business with a strong growth outlook given its provision of production services to the social media sector. It also has a bespoke software solution for companies requiring to manage in-house content for advertising on various media platforms.

Major negative movers in the portfolio (August reporting period)

Donaco (DNA) – a relatively small position in the fund fell 40% during month after losing an arbitration proceeding relating to the lease over its main asset being Star Vegas. This was a bizarre finding given the evidence provided, and DNA has filed an appeal to the Appeal Court in Phnom Penh. In the event the decision is upheld, and the lease is terminated, the lease provides that all buildings, fixtures and other property on the land are owned by Donaco, and the lessor must pay compensation. The current carrying value for these assets is US\$33m. In the meantime, DNA delivered a relatively strong profit result with net debt reducing to A\$9m. The Aristo business which is unaffected by the arbitration/appeal proceeding also performed much better than expected.

Tempo Australia (TPP) – declined 22% during August after a weak result which had been well flagged to the market. Cash flow was negative but only slightly so. The appointment of Paul Dalglish as CEO, we believe is a masterstroke given his background in contracting and his motivation to rebuild his profile after the demise of RCR after a Lazarus type recovery under his stewardship. We have only had good experiences with Mr Dalglish at RCR and would be supportive of a Tempo recapitalisation plan at the appropriate time.

Senetas (SEN) – declined 21% during the month for no apparent reason. The result was strong with revenue growing 12% and strong free cash flow (>\$5m). The company has nearly \$18m cash on its balance sheet and several early stage investments that could be quite valuable. Most importantly, SEN confirmed that Thales will continue to be its exclusive global distributor following its acquisition of Gemalto, a key competitor to SEN. We think the share price decline symptomatic of a market that is disinterested in any company who has slipped off the radar.

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	Spheria Australian Microcap Fund	Platform availability
Benchmark (universe)	S&P/ASX Small Ordinaries Accumulation Index	ASGARD
Investment objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.	BT Panorama
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	BT Wrap
Distributions	Annually	HUB24
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee	IOOF Portfolio Service
Cash	<ul style="list-style-type: none"> Up to 20% cash Typically 5% - 10% 	Macquarie Wrap
Expected turnover	20-40%	mFund
Style	Long only	MLC Wrap / Navigator
APIR	WHT0066AU	Netwealth
Minimum Initial Investment	\$100,000	One Vue
		uXchange

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