Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Performance as at 30th June 2019

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund^	**-2.6%**	**7.6%**	**-4.3%**	**9.4%**	**9.2%**
*Benchmark**	*0.9%*	*16.8%*	*1.9%*	*10.7%*	*10.2%*
Value added	-3.5%	-9.2%	-6.2%	-1.3%	-1.0%
*Microcap Index ** *	*-0.4%*	*19.1%*	*-2.9%*	*5.2%*	*6.8%*

^ 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.

Commentary

The Spheria Australian Microcap Fund returned -4.3% for the 2019 financial year, underperforming the Benchmark which returned 1.9%.

The market continues to be driven by macro-economic themes with little regard paid to traditional fundamental measures. Continued central bank monetary stimulus stoking tremendous asset bubbles in a variety of “fashionable” sectors including technology, property trusts and gold. Those looking at market averages to discern whether there is overvaluation are missing the point given the bifurcation of the market between the “haves” and “have nots”. In many cases the “haves” are not making a profit or very little relative to prodigious market valuations. The “have nots” on the other hand are trading on extremely depressed valuations that are pricing in the bleakest of scenarios, which seem statistically improbable.

The Spheria strategies were trampled like runners at Pamplona during June with the divergence between the two aforementioned camps noticeably widening, accentuated by heavy tax loss selling and large sell portfolio transitions due to several Australian small cap managers folding. The most significant downturn being at the small and microcap end of the market with less selling pressure when working up the market cap spectrum. We feel the microcap sector is now the most compelling from a valuation perspective since the GFC. Whilst we cannot forecast the catalyst that will drive a convergence in valuations between the camps, it feels like the winds of change are blowing particularly if the strategic interest in GBST (one of our key holdings) is any kind of gauge. Three months ago, we believed it was unlikely you could give the company away at $1.20, now it is trading at close to $3.60 with three parties registering interest in acquiring the company, the highest indicative offer at $3.65.

The Microcap strategy is currently littered with companies that possess “GBST like” characteristics, in that they are strategic in nature, inexpensive, produce sustainable cash flow, possess strong balance sheets and for whatever reason cannot curry any favour. These situations as illustrated by GBST can change quickly, with the speed and magnitude of the moves always astounding in hindsight. We will keep with our investment process and whilst performance has been disappointing, we remain confident on the medium to long term outlook for the businesses comprising the

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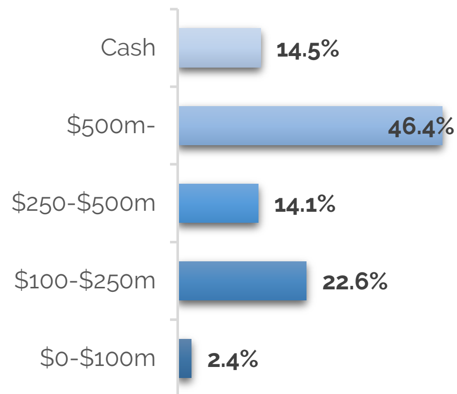
Top 5 Holdings

Company Name	% Portfolio
GBST Holdings..	4.9
Class Limited	4.8
City Chic Collective	4.7
Ht&E Limited	4.1
A2B Australia Ltd	4.1
Top 5	**22.7**

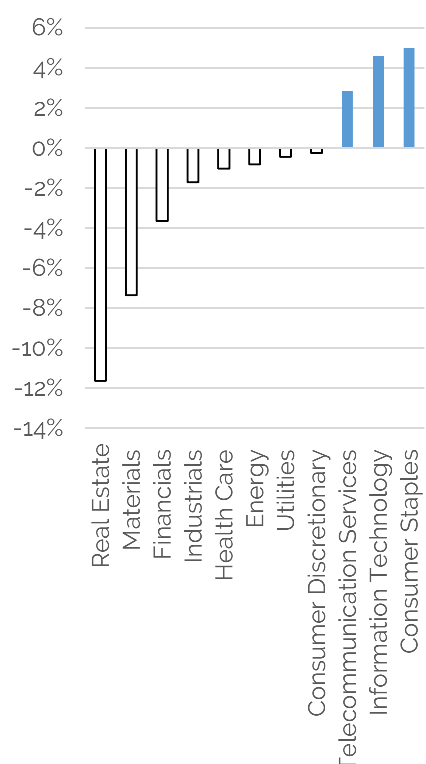
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

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portfolio, and the valuations are such that we believe the rewards should be handsome for the patient investor.

Top 3 Contributors for FY19

Mount Gibson Iron (MGX, owned) – MGX rallied 141% in FY19. At the end of FY18 the MGX share price was 43c and trading around cash backing, the sea wall at Koolan Island was being rebuilt and the iron price was trading US$65/tonne. In early calendar year 2019, the dewatering of Koolan Island was completed on schedule with the first shipment of iron ore occurring in April 2019. During this window, the iron ore price surged to over US$120/tonne. This fuelled the MGX share price which peaked at $1.30 in May and closed at just over $1 by the end of the financial year. During the period we reduced our weighting in MGX given our concerns around the sustainability of the iron price due to the temporary nature of global supply constraints.

City Chic Collective (CCX, owned) – CCX share price continued to rally after liberation from the legacy brands that were acquired by Noni-B (NBL) in FY18. In the past year, CCX has continued to deliver high single digit comparable sales and double-digit earnings growth. Online sales are 40% of total sales and growing rapidly with offshore wholesale growth into USA and Europe. We believe that CCX can continue to dominate and further penetrate the plus-size female clothing and accessory market in Australia and NZ. It is more an online play than a bricks and mortar retailer and remains relatively inexpensive especially when compared to its on-line peers.

Vita Group (VTG, owned) – VTG continued its turnaround from very oversold levels after Telstra remuneration changes announced a couple of years ago. The top line continues to grow with its private label accessories now representing the lion share of group profit, which should afford protection from recent remuneration changes and any future changes. Being aligned with Telstra, which seemingly has the best network capability (5G included) particularly in regional areas should see growth continue given VTG's store base is also skewed regionally. In our view, the market has continued to overreact to remuneration changes with Telstra not wanting to harm productivity by possibly pushing the franchisees to the brink. For example, VTG earns EBIT of only c$400k per store on average. All Telstra franchisees are on the same financial arrangements, and therefore smaller franchisee clusters without private label we believe would be earning a lot less.

Bottom 3 Contributors for FY19

Class (CL1, owned) – CL1's share price fell 36% over FY19 including dividends. The business de-rated significantly as net account additions slowed due to a more effective incumbent response to CL1's share grab and investor concerns around the SMSF industry mounted given proposed changes to franking credits by the Labor party. The latter proved to be a false alarm given the Liberal government win, however, it did slow industry growth as SMSF fund closures accelerated. This was possibly also driven by the inability to fund gearing of property in SMSF's due to tighter bank controls and the perception that SMSF's with low balances cannot be run economically due to high administration costs. We believe some of these issues are overplayed and that the closure rate will reduce moving forward as the cost of managing an SMSF continues to fall due to the uptake of automated software. The more effective incumbent is real but it is now acting more rationally with a price increase of $10pa on 1st July 2019. This should allow CL1 to increase price which will significantly benefit the bottom line. We continue to believe the competitor is not making much money due to its greater headcount and lower pricing, and as such pricing in the industry may continue to rise benefiting all participants. The family trust and related adjacencies (that CL1 service using Class Portfolio) represent significant growth for CL1, which is the first mover in this space. There are estimates that the total addressable market for Class Portfolio is greater than the SMSF market. At <4x revenue we continue to see CL1 as offering exceptional upside for a SaaS business.

Isentia (ISD, owned) – ISD undertook a painful strategy of reducing price to reduce churn in its customer base. The effect was a significant rebase of earnings. The stock also de-rated significantly but is in better shape now with a new management team in place that looks to be turning the business around relatively quickly. The software has been re-engineered and improved, and the largest input cost being copyright is likely to fall significantly in CY20, which means it will be better able to compete with Meltwater (global player), who had a much better contract

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allowing it to undercut ISD. The business remains highly cash generative and the dominant player in the media monitoring market with over 60% market share.

A2B (formerly Cabcharge, owned) – A2B de-rated over the year with the market obsessed by the rise of ride sharing companies. The fact that the ride sharing industry is uneconomic appears irrelevant at this stage given the market willingness to fund such companies on the hope that one day they make a profit. Taxis continue to maintain share in the personal transport market in Australia with "rank and hail" regulatory protection, and metropolitan population density playing in their favour. A2B's earnings continue to weather the storm and further consolidation of the taxi industry seems likely such that A2B's market share of the taxi industry might increase from 20% to much higher levels which will insulate earnings, and potentially re-establish a growth profile. The balance sheet is strong with cash >$10m providing A2B opportunity to drive industry consolidation via M&A. Lastly while we make no account for the potential upside in our valuation, we note that A2B is likely to be the largest claimant in the current class action against Uber for illegal operation and the devaluation this caused taxi licence plate holders.

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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