

Performance as at 31st August 2019

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	-2.0%	4.4%	1.3%	10.5%	11.2%
<i>Benchmark*</i>	-3.0%	6.0%	1.4%	9.2%	10.4%
Value added	1.1%	-1.6%	-0.1%	1.3%	0.8%

^ 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
TABCORP Holdings	5.6
Crown Resorts Ltd	4.6
Coca-Cola Amatil	4.5
Flight Centre Travel	4.3
BlueScope Steel Ltd	4.2
Top 5	23.3

Source: Spheria Asset Management

Commentary

The Spheria Opportunities Fund declined 2.0% for the month outperforming the Benchmark which declined 3.0% by 1.1%.

The mid-small cap index fell 3% 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 fundamental 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 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.

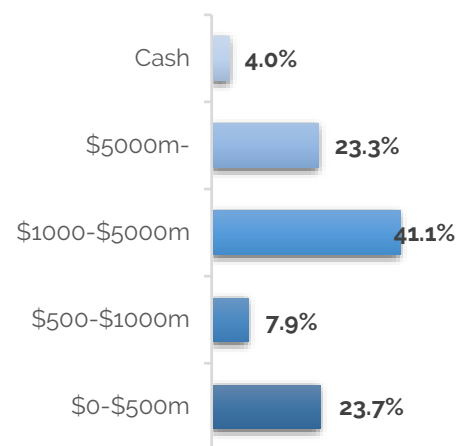
Our strategies are heavily skewed to mid-small cap value and this has detracted from performance in recent periods. However, like Michael Burry we believe this is where the opportunity is but only the minority will take advantage of this situation given the closure of many value based small cap managers 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.

Major positive movers in the portfolio (August reporting period)

City Chic Collective (CCX) - rallied 18% in August after reporting another strong result post last year's restructure and divestments. CCX is a specialist at plus-size female fashion with 44% of sales online, up from 36% in FY18. Northern Hemisphere sales (mainly USA) comprise 20% of group revenue, up from 16% in FY18. The company generates strong cash flow and has net cash of \$23m.

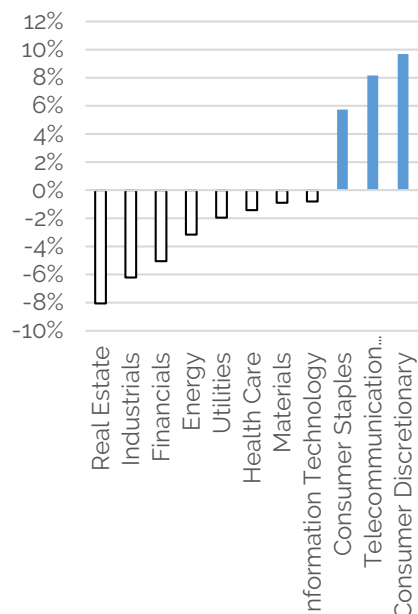
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Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Inventory is very low (\$19m) as you would expect given the high online component of group sales. Trading on a free cash flow multiple of 14x, we think it's relatively cheap versus its online peers that mostly sell third party product and generally exhibit weak cash flow trends.

JB Hi-Fi (JBH) – continued to rally (11%) in August after reporting a solid result despite difficult market conditions. The Good Guys division pleasantly surprised given weakness since acquisition and challenging conditions in the housing market. The company should benefit from an improvement in the housing market going forward whilst the core electronics division continues to be the market leader but is beholden to product releases and economic cycles given its store network is highly penetrated.

Healius (HLS) – rose 11% after a better than expected result, albeit expectations were low leading into the result. The medical centre division which has been a millstone around HLS's neck for a long time showed encouraging signs of a turnaround in the 2H19. There continues to be speculation that HLS will be taken private that has also bolstered the share price. We continue to view the company as primarily a pathology business (second largest in Australia) and believe this is not yet reflected in the share price given peer trading multiples.

Major negative movers in the portfolio (August reporting period)

Blackmores (BKL) – fell 19% after reporting a weak result. Expectations were low going into the result given BKL's lack of traction with its China strategy, and the impact on Daigou trade in Australia due to a Chinese government crackdown on this channel. The market disliked the outlook however. Further weakness in sales is expected in 1H20 as Chemist Warehouse (BKL's largest customer) apparently over-stocked in 2H19. Whilst conditions will remain difficult in the short to medium term given weakness in China and Australia sales, more pertinent is the company is on a path that will drive significant cost out of the business (with a new highly experienced MD appointed) and potentially generate much higher margins more akin to its peers. However, this will be a painful process and potentially costly given the headcount of 1400 people within the business. On a positive note, the Asian division (ex-China) grew sales >30% in FY19 and comprises nearly 20% of group sales and is nearly equivalent to China (in-country) sales.

Class (CL1) – dropped 18% during the month despite a strong result with revenue growing 13%. The solid result was overlooked due to guidance that the company will invest more aggressively in product development and technical capability to improve the current product suite and enter new adjacencies. Revenue is expected to grow at 10% in FY20 but margins will fall due to the investment, meaning earnings will be broadly flat. If the company was popular this would have been met with resounding cheers from the market with a thirst for top-line growth, but given the antipathy toward the stock it was instead met with derision. Emotion seems to be overriding any common-sense with many market darling technology companies losing money to deliver top-line growth being richly rewarded by the market. Many will never make money. This would appear a dangerous game given what we learned during the Dot-com boom and ensuing bust. CL1 is clearly not in this camp given it has highly recurring revenue (~\$40m) and is generating EBIT of around \$12m pa and has nearly \$20m of surplus cash. At 3x EV/Revenue for a SaaS business with 99% client retention we feel strongly that a shift away from the prevalent momentum strategies should see CL1 shareholders richly rewarded for their patience.

Platinum Asset Management (PTM) – declined 18% during the period on the back of continued fund outflows and weak relative investment performance. The investment manager being caught in the malaise of being a value investor in a market thirsting for growth at any price. Clearly, the risk is that outflows continue given the loss of confidence in the manager. Consultants and clients can only take so much pain. The flipside being a market shift from growth to value is faster and more pronounced. Given our view that the current environment is analogous to conditions last seen in the dot-com boom, we think the latter is a high probability scenario. On our valuation measures PTM is trading on an EV/EBITA < 10x and a >6% fully franked yield. The balance sheet being in a \$200m net cash position + \$100m of listed investments necessarily inflates the PE ratio, making it an unfair measure relative to peers that are lesser capitalised and, in some cases, financially geared.

Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU



	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	<ul style="list-style-type: none">• Up to 20% cash• Typically 5% - 10%
Expected turnover	30-40%
Style	Long only, risk aware
APIR	WHT0025AU
Minimum Investment	\$25,000

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