Spheria Australian Smaller Companies Fund

ARSN 117 083 762 APIR WHT0008AU

Performance as at 30th April 2020

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund ^	**14.8%**	**-18.7%**	**-20.2%**	**2.8%**	**3.0%**
*Benchmark**	*14.3%*	*-15.2%*	*-13.3%*	*3.2%*	*3.1%*
Value added	0.6%	-3.5%	-6.9%	-0.5%	-0.1%

^ 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.

Top 5 Holdings

Company Name	% Portfolio
Adelaide Brighton	4.7
Healius	4.4
Bega Cheese Ltd	4.2
Class Limited	4.1
Asaleo Care Limited	3.7
Top 5	**21.1**

Source: Spheria Asset Management

Commentary

The Fund returned 14.8% (after fees) in April, outperforming it's benchmark by 0.6%.

John Maynard Keynes — "When the facts change, I change my mind - what do you do, sir?"

There appears confusion around the difference between the infection rate and the mortality rate from COVID-19. The social distancing measures are aimed at reducing the infection rate in the community but will have no real impact on the actual mortality rate of people infected by the virus (in the absence of treatment advances). The so-called "flattening the curve" essentially bought time by reducing the infection rate, thus alleviating potential pressure on the hospital system based on dire projections that fortunately have not borne out.

Australia's high testing rates per capita mean that our data in respect of the level of infection in the community has greater statistical integrity than many countries where testing has been less widespread. Nonetheless, we are not capturing all the infections given there will be people who were unaware they had COVID-19 and therefore have not been tested i.e. 'asymptomatic'. In effect, any mortality calculation without testing the entire population for COVID-19 and for anti-bodies is overestimating the mortality rate.

Bearing this in mind and based on the Australian statistical data so far, there is substantive evidence (+4600 positive cases) that the actual mortality rate for healthy people under 60 years of age is insignificant (chart overleaf). In fact, no person under 40 years of age has died from COVID-19 in Australia despite high levels of infection. Therefore, the mortality rate under 40 years of age is currently zero. There are 13m people in Australia under the age of 40 years of age and nearly 20m people less than 60 years of age - according to ABS statistics - the Australian population is only 25m. A large part of the total population should therefore be able to revert to something close to 'normality' without undue health concerns, and thus we believe consensus is under-estimating the potential pace of re-opening.

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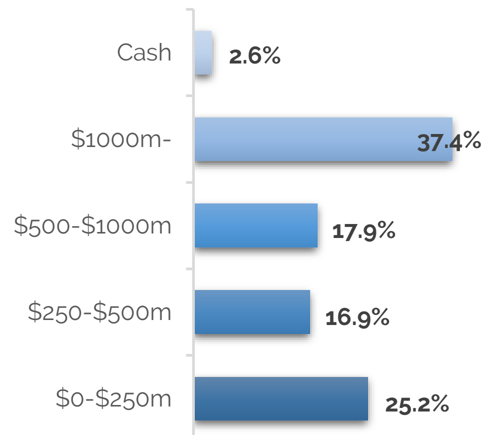
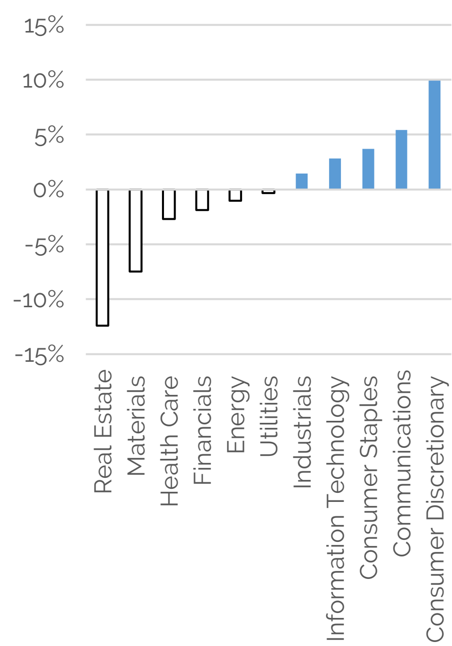
Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

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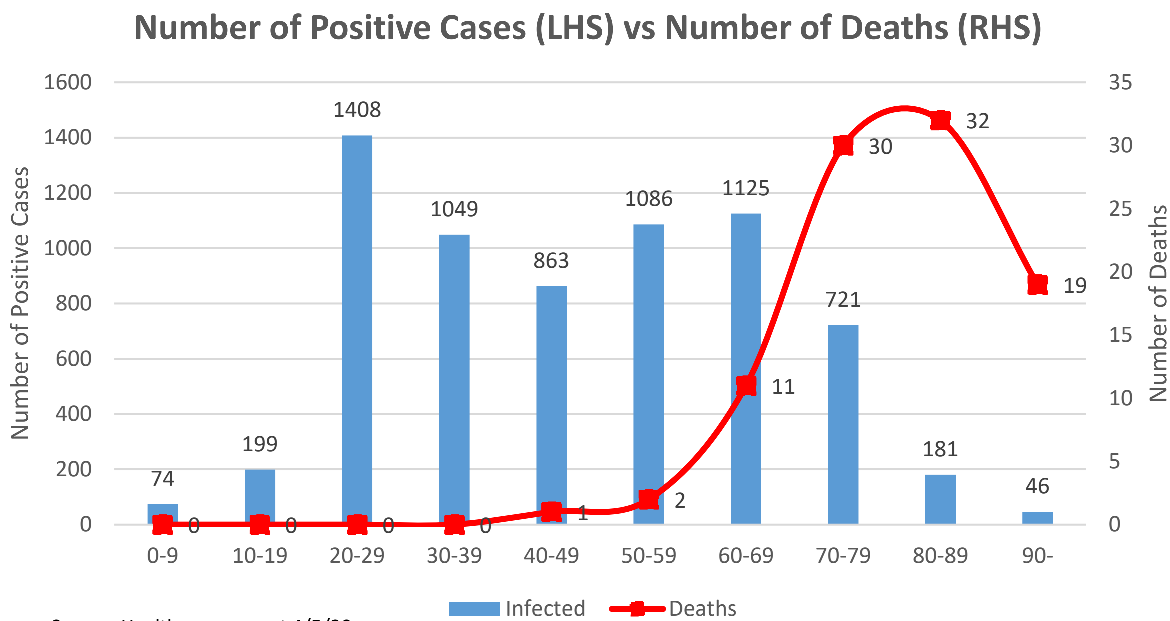

Source: Health.gov.au as at 4/5/20

Back to the infection rate and concerns regarding the "second wave" - well unfortunately this is likely to be a reality given COVID-19 is highly contagious. There will almost certainly be periodic break outs of clusters of cases as the State and Federal Governments move to re-open segments of the economy. This is where the continued strengthening of testing regimes and the uptake of the COVIDSafe app is important to enable health officials to quickly identify the infected and contact trace people who may have been exposed to COVID-19. This should alleviate concerns of exponential case growth in the community. Even in the absence of a vaccine however, we suspect the authorities will find a happy medium that enables most of the sectors impacted by the lockdown to at least partially re-open (albeit likely with modified operating procedures to allow for a modicum of social distancing).

How have we positioned for the re-opening?

As would be expected, when you lockdown most of the population the most impacted sectors were consumer facing in nature or some derivative thereof including media and consumer finance. Whilst short term earnings for companies exposed to the consumer will be diabolical in most instances, it appears a combination of rent relief, bank forbearance and government funding will see many of these companies safely to the other side. Many of these businesses have also taken the opportunity to reset their cost base and recapitalise their balance sheet to ride out an extended downturn with very little forecast revenue in some cases. If the pace of re-opening as we envisage is faster than anticipated, many of the companies will have over-raised thus they will be in an enviable position to return capital to shareholders or deploy capital if returns are adequate.

Portfolio holdings we have initiated that will benefit from the re-opening include:

- **Auckland International Airport (AIA)** via a large capital raising and subsequent purchases – whilst there are valid concerns around when international travel will restart for New Zealand given low levels of immunity amongst the population, we note domestic travel represents 45% of passenger traffic,

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- with trans-tasman traffic accounting for roughly half of the remainder. In addition the group has a substantial rent roll from surrounding properties mainly serving the logistics industries. The group has de-geared significantly and sits on a large bank of surplus property that underpins the valuation in absence of a return to normal levels of profitability.
- **Burson (BAP)** via capital raising and on-market purchases – BAP is primarily a trade distributor of automobile parts. It entered the downturn over-geared and last month raised over A$200m which provides it plenty of capital to ride out the lockdown induced downturn in aftermarket auto parts demand.
- **Corporate Travel (CTD)** via on-market purchases – has significant flex in its cost base with a headcount largely variable in nature (consultants based in call centers or working remotely from home) and proprietary technology that has automated many previously manual processes. This means cash burn in the current low revenue environment is modest in comparison to say a retail travel agent. The business remains in a net cash position and should be an early beneficiary from a recovery in Asian corporate travel (large part of CTD business), which was first into the lockdowns and is likely to be first out. Additionally c60% of group revenue is generated from domestic travel, so CTD should return to a breakeven or better position when some of this activity resumes, even assuming borders remain closed.
- **G8 Education (GEM)** via on-market purchases – the government has effectively underwritten the childcare sector during the downturn via a government funding mechanism pegged to enrolments at the end of February 2020 and the introduction of the JobKeeper allowance. Rent deferral will also allay cash flow issues. GEM raised significant amount of capital last month such that its balance sheet can ride out an extended downturn given it now has minimal debt and is cash flow breakeven until at least the end of June.
- **Vista Group (VGL)** via capital raising and on-market purchases – Vista is the global leader in ERP software for the cinema exhibition industry. While revenue is ordinarily insensitive to its customers' ticket sales, the lock down of the vast majority of its client's operations means most are currently unwilling or unable to pay subscription and maintenance fees, putting significant pressure on VGL's cashflows. VGL raised NZ$65m last month which will provide it enough capital to meet cash flow obligations through to the end of December 2021 even assuming no re-opening of its clients' cinema circuits. VGL now screens as one of the cheapest ASX software exposures on a price / revenue basis, even after assuming a material reduction to its pre-COVID-19 revenue run-rate.

Portfolio holdings that we have increased that will benefit from re-opening include:

- **Village Roadshow (VRL)** via on-market purchases – VRL owns theme parks on the Gold Coast and Cinemas which are all temporarily closed. We have heard numerous times in the past that Cinemas will be displaced by home entertainment, many years ago it was expected home cinemas/DVDs would spell the end and now it is PVOD. We suspect once the fear recedes in respect of COVID-19 that cinemas will see a strong recovery particularly given there is a strong theatrical line up that has been delayed for release by studios until later this year when it is expected most cinemas globally will have re-opened. The theme parks could also benefit from greater domestic interest if borders remain shut, that should go some way to replacing lost overseas tourists.
- **City Chic (CCX)** via on-market purchases – CCX was flying before the lockdown, whilst online sales have increased it has not been enough to offset the closure of bricks and mortar which represents around 40% of group sales normally. We expect CCX to re-open its store network in the next few weeks. There is little downside in doing so given JobKeeper fully funds in-store staff until September and the company will be paying rent based on store turnover.

It's very easy at this point the sharemarket cycle to become overtly bearish given the all-pervading negativity perpetuated in the media (the old adage that bad news sells papers) and the obvious impact on many parts of the economy from the lockdown. Instead of dwelling on these obvious negatives, we believe it is time to be constructive and have purposefully positioned the portfolio for a faster paced re-opening, and concomitant economic recovery whilst also introducing several "growth" companies during the downturn that were previously too expensive to even contemplate. The rotation to recovery names from perceived safety, we believe could pay off handsomely in the medium to long term for our portfolios, given the renewed divergence between growth/defensive stock valuations and pretty much everything else.

	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
ASGARD
BT Panorama
BT Wrap
First Wrap
HUB24
IOOF Portfolio Service
Macquarie Wrap
mFund
MLC Wrap / Navigator
Netwealth
One Vue
uXchange