Spheria Australian Smaller Companies Fund

ARSN 117 083 762 APIR WHT0008AU

Performance as at 31st May 2019

	1m	FYTD	1yr	2yr p.a.	Inception p.a.#
Fund ^	**-2.2%**	**5.5%**	**5.8%**	**16.0%**	**11.6%**
*Benchmark**	*-1.3%*	*1.0%*	*2.1%*	*13.1%*	*8.9%*
Value added	-0.9%	4.5%	3.7%	2.9%	2.7%

^ 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

The Spheria Smaller Companies Fund returned -2.2% for the month of May underperforming the Benchmark which fell 1.3%. For the year ending 31st of May 2019, the Fund returned 5.8% net of fees outperforming the benchmark by 3.7%.

The market, as is often the case in May, paused for breath as it digested the strong performance of the previous month and a plethora of local and global machinations. Locally we had the outcome of the Federal election which provided some much needed certainty to the local outlook and a more stable view on taxes and other regulatory changes which would have been brought in by the Labor Party. Globally the tariff war between the US and China increased in intensity whilst Central Banks around the world started back on an interest rate easing bias.

The certainty around Australia's domestic economy strengthened significantly after the election result and this saw a number of cyclical and housing related stocks rebound over May. Chief amongst those we held was Mortgage Choice (MOC.ASX). MOC in many ways typifies to us the anatomy of a good investment. What is the anatomy of a good investment? We think they share several traits – firstly they generate good cashflows. These don't necessarily need to be non-cyclical, but it helps if the cycles aren't too extreme and there is some predictability to the earnings and cashflows of the company. Secondly the business generates strong returns on capital (or is capital light), thirdly it operates with reasonable margins and fourthly it has a strong management team (who instil operational excellence and who understand their role in capital allocation). Other important factors we like to see include a reasonable length of listed operating history since this enables us to better assess the business cycles, competition, cashflow generation and capital allocation. Lastly, we like to be able to invest in all of the above at a share price materially under what we think the business is worth.

MOC operates as a franchise operator for mortgage brokers. This means it is capital light and has an enviable record of cash generation (98% cash conversion for the past 10 years) coupled with a net cash balance sheet. Operating margins are typically in the mid to high teens – albeit they are likely to be low double digit this fiscal year. Finally, although there is a reasonably new executive team at MOC they have already acted to improve commission structures for franchisees (lowering profitability but

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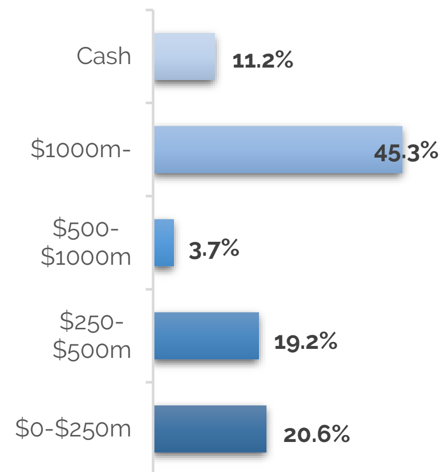
Top 5 Holdings

Company Name	% Portfolio
Navitas Limited	5.7
Fletcher Building	4.5
Ht&E Limited	4.5
Healius	4.4
Bega Cheese Ltd	4.2
Top 5	**23.3**

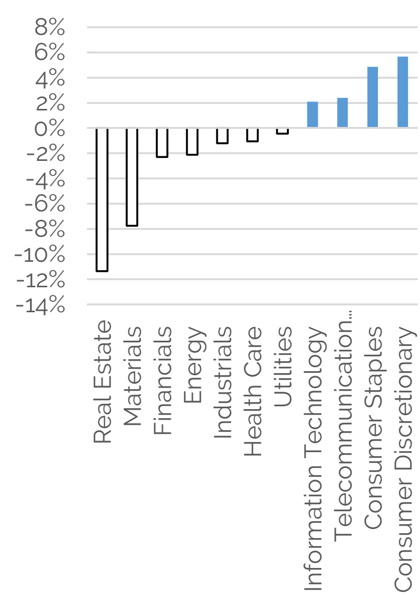
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

extending duration and making it more attractive proposition for new franchisees) and continue to pay out substantial dividends. We were also able to buy these shares at a material discount to our assessed valuation of the business. Sentiment had been so negative in fact that we were able to add to our position for less than our assessed fair value of the trail book alone, meaning that we were getting paid to invest in a stream of earnings MOC was already entitled to (MOC earns commissions on mortgages written in the current year plus is entitled to trail commissions from already written mortgages which are still in force). MOC hit a low of 80c just before the election in Mid-May and has since risen almost 50% to close the month at $1.19.

The Fund also saw strong performance from HT&E (HT1.ASX) which rose 7% and a rebound in Beacon Lighting (BLX.ASX) up 17%. We had taken advantage of the depressed prices in BLX to add to our position as we felt the market had overly discounted the impact of a housing downturn on the business. BLX also derives a material amount of its sales from renovation projects in addition to new builds and is diversifying its business into ceiling fans and street lighting.

On the other side of the ledger Class Ltd (CL1.ASX) declined 24% on limited news flow (having performed strongly from the beginning of the year). The Coalition retaining Government should have provided some certainty with respect to SMSF investors' entitlement to franking credit refunds and thus share price support for CL1 given what we feel is an attractive valuation. An onslaught of negative commentary on SMSFs (from competitors including industry funds and platforms) has slowed overall industry growth however and impacted sentiment. We still believe over time SMSF's to be a strong proposition for clients wanting control over their superannuation particularly as the cost of managing SMSFs continues to fall due in part to the automated software technology that Class provides. It is possible that the large number of transitions we are seeing through the small cap market at the moment is having some impact on CL1 which isn't reflective of its outlook. Technology One (TNE.ASX) declined 18% during May after delivering an inline first half result. TNE however had performed very strongly since its weak first half in 2018 and it is safe to assume the market had expected more. Lastly, A2B Ltd (A2B.ASX) – formerly Cabcharge – fell 11% over the month on the possibility of some slight reductions in their Victoria card transaction commission rates. It is possible these reductions are adopted by other States placing more financial pressure on taxi drivers and favouring ride share companies that are losing money with no obvious path to profitability. The low interest rate environment is rewarding risk taking and stoking asset bubbles across different sectors of the economy including ride sharing. We expect the class action brought on by taxi licence holders against Uber to be a watershed case for the industry and potentially hugely value adding for A2B given it was the largest licence owner in Australia when Uber seemingly operated outside the law.

The disparities in valuations between the popular and unpopular stocks at present continue to offer compelling opportunities, we feel. Whilst most global equity markets appear to be awash with liquidity we have been around investing markets long enough to understand that conditions can and do change periodically. Given that the timing of these types of events are usually entirely unknown we believe our investors remain best served by our continued bottom up investment focus. The constant waxing and waning of investors moods will offer opportunities for us to invest funds appropriately for our clients.

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