

Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU



Performance as at 31st May 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.#
Fund[^]	1.3%	21.8%	68.4%	12.8%	14.4%
<i>Benchmark*</i>	0.3%	10.4%	26.7%	7.9%	10.5%
Value added	1.0%	11.4%	41.6%	4.9%	3.9%
<i>Microcap Index**</i>	2.0%	16.1%	63.3%	50.9%	14.0%

[^] Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes. All p.a returns are annualised.

* 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 1.3% (after fees) in May, outperforming its benchmark by 1.0%.

Markets

The Smaller Companies index was up very modestly over May however the capital markets have kicked into overdrive. Announced M&A deals (many not completed as yet) were amongst the highest levels the ASX has seen in the last 20 years. The IPO market is also experiencing high levels of activity as entrepreneurs and Private Equity seek to hit the exit whilst the IPO window is open. As is often the case however the rush for the exits eventually fatigues the time, patience and interest of the market and a number of recent attempts to hit the market have been pulled as the finely balanced scales between cynicism and opportunism tip back in favour of the former.

The market concerns around inflation remain highly topical. Tomes have been written on whether we will see inflation and if so for how long this rarely seen mythological beast will continue in our midst. Having said that, the conditions for its re-appearance have never been better. The modern-day conjurers (aka the Cabal of the Central Bankers) have been brewing their caldrons for several years now, perfecting the secret herbs and spices, to make a heady cocktail for its re-appearance. Its little wonder then that the combination of this brew plus the super stimulus from Covid 19 is starting to work through the economic system. Short term observable inflation indicators are up hugely – freight rates have doubled, raw material prices are at record levels, consumer demand and confidence is strong, and we are experiencing a number of supply shortages (computer chips, cars, etc.). Covid-induced lack of migration is also biting many industries with hospitality and mining in particular struggling to fill job vacancies. Wage pressure in the West is now fairly extreme although when mobility eases there should be some relief for this pressure cooker. For now, the Cabal has managed to persuade markets that they can conjure up the inflationary beast yet keep the longer-term impacts in a convenient bottle.

The Fund was again the beneficiary of corporate activity due to the style of companies we invest in. Cash flows are attractive to Private Equity and corporates precisely because it enables them to lever up to make the

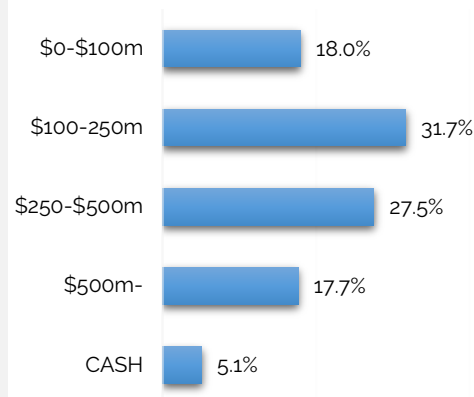
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Top 5 Holdings

Company Name	% Portfolio
Supply Network	4.8
Michael Hill Int	4.2
Class Limited	4.1
A2B Australia Ltd	3.7
Nzme Limited	3.5
Top 5	20.3

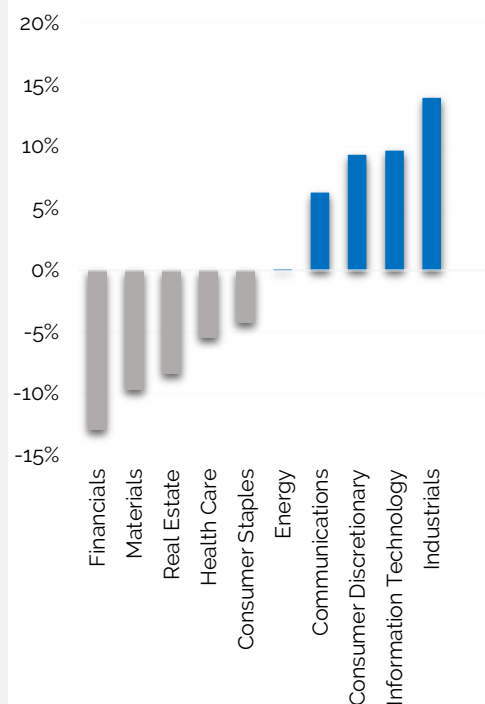
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

acquisition. During May we saw a bid emerge for APN Property (APD.ASX) at around a 66% premium to our average and fairly recent entry price. This has been the third acquisition of our portfolio holdings in the past 6 months – the others being Mortgage Choice (MOC.ASX) and Asaleo Care (AHY.ASX). The other area of heightened activity in the market at the moment is the IPO market. We are highly selective with IPO's and approach them with caution. Since the end of September, we have invested in only around 4 out of the 29 IPO's (the total number of raising above \$30m). Whilst the results of our investments here have been solid, we do not rely on this as a key performance generator for the Fund. We typically look for companies with a decent length of financial history and limited to no private equity involvement, solid cash flow generation and a supportive valuation before investing.

Major Contributors for the Month

Gentrack (GTK.NZ) a NZ based billing and customer care software provider to the Utility sector rose 34% over the month after reporting an improved h1 result and raising guidance for their FY21 year. Based on the stabilization of the business and the turnaround currently underway the company doubled its EBITDA guidance for FY 21. GTK has NZ\$16m of net cash on the balance sheet, fully expenses its R&D expenditures. On our forecasts GTK is trading on around 12x FY 22 EV/EBIT for a SAAS utility software provider. Other contributors were **APN Property Group (APD.ASX)** which rose 59% over the month after it received an agreed takeover bid from Dexus. APD was trading extremely cheaply before the bid with the internal fund manager trading on only 4x EV/EBIT once you had backed out the stake in the property funds it managed. **Supply Network (SNL.ASX)** rose 12% over the month after being sold off on low volumes during the previous month.

Detractors over the month included **Vista Group international (VGL.NZ)** which retraced 11% over the month after a strong performance so far this year on Covid concerns emanating from India. This makes little fundamental sense however as many of the markets VGL is exposed to (North America, Europe) are re-opening and cinema attendance is recovering. As the world's leading cinema ERP software firm, we think the market is still underestimating the upside to earnings when cinema exhibition returns to something resembling normality. **Seven West Media (SWM.ASX)** declined 16% over the month on limited news flow. The announcement in late May that Nine Entertainment Co (NEC.ASX) had also reached an agreement with Facebook and Google for content sharing worth in the vicinity of \$30-40m pa continues to give us confidence that earnings are likely to materially recover in FY21 and FY22 with a substantial improvement in the balance sheet. Longer term media consolidation in Australia remains the most likely scenario. **Austin Engineering (ANG.ASX)** declined 14% over May after announcing the retirement of their current CEO despite reiterating profit guidance for FY21. ANG has extremely low gearing and is trading on a very modest 6x current years expected EV/EBIT.

Outlook & Strategy

Little over the past few months has allayed our concerns that parts of the market are over-extended. Retail investors have rushed back into the market with fervour. This has pushed areas – especially in micro caps – to levels that are hard to justify on fundamentals. Oddly however there remain pockets of market where there is complete investor disinterest chiefly in areas where there are temporary earnings lags or there is a perception that the sectors are not high growth or disruptive. Should inflationary forces return on a more permanent basis longer term interest rates may continue to rise. We continue to believe adhering to a valuation discipline with this backdrop is the best way to serve our investors over the cycle.

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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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