

Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU



Performance as at 30th September 2021

	1m	6m	1yr	3yr p.a.	5yr p.a.	Inception p.a.#
Fund[^]	2.5%	23.6%	65.6%	16.7%	15.1%	16.5%
Benchmark*	-2.1%	12.2%	30.4%	9.4%	10.2%	11.1%
Value added	4.7%	11.4%	35.2%	7.2%	4.9%	5.4%
Microcap Index**	7.7%	28.6%	55.9%	22.7%	14.3%	16.5%

[^] 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. All p.a. returns are annualised.

** 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 2.5% (after fees) during the month of September, outperforming the ASX Small Ordinaries Accumulation Index by 4.7%. Over the past year to the end of September the Microcap Fund has returned 65.6% beating its benchmark by 35.2%.

Markets

Markets declined both here and internationally over September after putting in a robust performance in the previous month. The Smaller Companies index was dragged down by materials, healthcare and software and services which took a breather after posting strong returns over the past year. The beaten down Energy sector bounced hard with oil and energy prices maintaining their upward trajectory and demand recovering in the Northern Hemisphere with economies re-opening. Oil prices are touching US\$80/bbl a level not seen since mid 2014 with US gas prices also back up to a 7 year high. Gas supplies appear to be extremely tight in Europe and the UK in particular causing some significant increases in prices in local markets.

Transport and travel names also performed well as investors started to look through to the Australian economy re-opening and the re-commencement of local and international travel (finally!). We believe we are in the midst of a massive spending shift from goods back to services. The synchronised global spike in demand for goods has strained global manufacturing from chips to automobiles and put significant upward pressure on freight rates and port logistics. As people are allowed to travel again, we would expect a significant reversal back to services and in particular travel and leisure which has been suppressed by Government mandated travel restrictions. Early signs in New Zealand showed the big jump in travel demand massively exceeded the travel undertaken in 2019 and assuming capacity is restored it would seem likely that we will see the same development in Australia.

The other major issue investors are grappling with remains inflation and the long-term bond rates implied by rising inflation. So far, the official narrative from Central Bankers remains that this increase in inflation is temporary, however we remain sceptical. We use an 8% discount rate in all our models and implicit in this is a 3% 10-year bond yield (vs. around 1.5% as we write

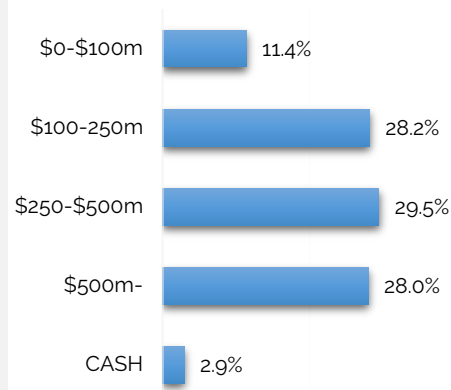
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Top 5 Holdings

Company Name	% Portfolio
Vista Group Int Ltd	4.8
Supply Network	4.7
Class Limited	4.3
Michael Hill Int	4.1
Mader Group Limited	3.9
Top 5	21.8

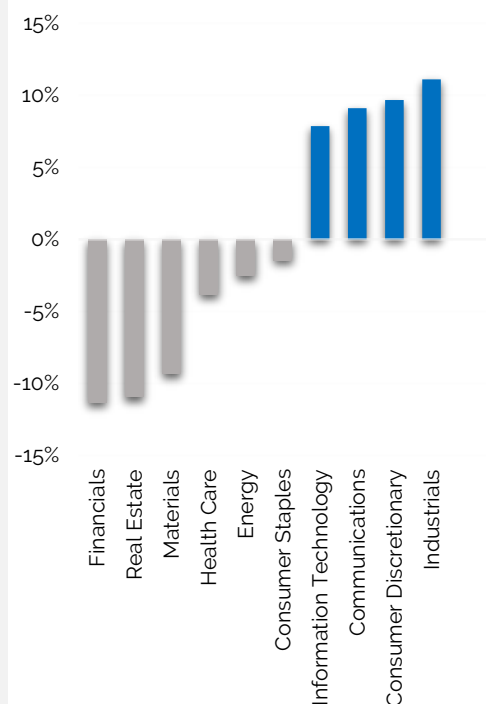
Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

this) and an equity risk premium of 5%. We think rates are likely to trend back up over time and importantly our valuations assume this to a reasonable extent. We would suggest that investing in stocks now whose sky-high valuations are predicated on the assumption that rates stay sustainably this low for a long time from here really is metaphorically speaking akin to reaching down in front of a bulldozer to pick up pennies.

Major Contributors for the Month

Mader Group Ltd (MAD.ASX) was the most significant contributor to the Fund rising 40% over the month. Mader offers fixed plant and equipment maintenance to mining companies in Australia and abroad saving customers a significant amount compared the relatively expensive maintenance costs provided by equipment OEM's. In late August Mader reported a strong set of FY21 numbers – considering the impacts of covid and the market's fears around wage inflation in the West. In addition, they provided guidance for 20-30% earnings growth in FY22 as the group continues to expand successfully into the USA where to date there has been limited competition. MAD has a strong ROIC of over 40%, modest gearing and still trades on only 6x FY22 EV/EBIT in spite of the significant share price move over the month.

Helloworld (HLO.ASX) gained 41% over the month as the shares flew out the door. HLO reported a very depressed set of earnings in August as travel volumes cratered (down 85% compared to pre covid levels) over the previous twelve months. Q4 started to demonstrate some recovery with the firm posting a very modest loss on volumes still 75% under their FY19 level. HLO raised capital during the pandemic and still sits on around \$50m of net cash. Our earnings forecast has HLO trading on high mid-single digit EV/EBIT as earnings recover from trough levels.

Vista Group (VGL.ASX) was the next largest contributor up almost 12% as this world leading cinema ERP software business continued its recovering trajectory as cinemas in the Northern Hemisphere re-open. VGL announced the launch of Vista Cloud in late August after beta testing with some of their customers. This should offer the group opportunities to further expand their significant market share and increase their revenue from hosting revenue streams as customers outsource the running of the software to VGL to save on-premise capex budgets. The early signs from the Cinema industry's re-opening remain very positive. VGL is trading on sub 20x partially recovered EV/EBIT 2 years out and a fraction of the revenue multiples of its software peers.

Major Detractors for the Month

Seven West Media (SWM.ASX) detracted as the share price retraced 18% over the month on limited news flow. As we have discussed in previous monthlies, SWM is one of the cheapest media franchises in the country with a strong management team who are executing on a cost out and de-levering of the company's balance sheet. SWM has attracted a significant increase in their digital audience on their BVOD (broadcast video on demand) services after their success in showcasing the Olympics. How they monetise this and control costs remains crucial to the medium-term story. We view their business as being central to any likely media consolidation in Australia, yet the company trades on a mere 4.5x EV/EBIT.

Class Ltd (CL1.ASX) declined 12% during the month again with limited obvious catalyst other than the market's simple ennui with small technology firms. We remain attracted to the high customer retention rate at Class (99.1%) and the strong organic growth prospects they have in their product adjacencies; Class Portfolio and Class Trust as well as Doc tech under their NowInfinity brand. CL1 continues to look extremely attractive compared to most technology firms listed in the smaller companies space on just 14x our estimated FY22 EV/EBIT.

Vita Group (VTG.ASX) fell 12% over the month as they announced the sale of their ICT (Information and Communication Technology) business to Telstra for \$110m a number which was slightly disappointing to the market. VTG's other business – Artisan skin clinics – performed well over FY21 with revenue rising over 40% and the division breaking into profitability for the first time. This is a huge testament to the management at VTG who have essentially grown this business from scratch over the past 3 years. VTG will pay a large special dividend (39-45c –

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fully franked) and retain \$35m of the sales proceeds to continue the growth of Artisan Clinics. VTG has also retained a net cash balance sheet throughout, and we would expect the market to eventually appreciate the growth possibilities at Artisan to which the market is ascribing almost no value.

Outlook & Strategy

As has probably become apparent from the commentary above we see a number of significant economic pivot points approaching. The first is a consumer spending swing back to services and away from goods. The second pivot point is the possibility of higher medium term interest rates and more persistent inflation than our Central Bankers would have us believe. Change leads to opportunity – the key is to be prepared and willing to make investment changes. We remain surprised, although we have been around long enough not to be so, by the over-enthusiasm investors appear to have for money-losing disruptors in the small and mid-cap space. We are however more convinced by long-term investment history which suggests that unless new ideas make money in a reasonable timeframe, the fascination eventually wears thin, and investors will jump on board the next new thing leaving the old idea to wither in the market's basement of forgotten dreams.

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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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