Spheria Opportunities Fund

ARSN 144 032 431 APIR WHT0025AU

Spheria ASSET MANAGEMENT

Performance as at 31st December 2018

	1m	FYTD	1yr	2yr p.a.	Inception p.a.#
Fund ^	**-5.4%**	**-9.0%**	**-3.7%**	**8.1%**	**8.0%**
*Benchmark**	*-2.9%*	*-11.3%*	*-8.0%*	*5.6%*	*6.1%*
Value added	-2.5%	2.3%	4.2%	2.5%	1.9%

^ Spheria Opportunities Fund. Returns of the Fund are net of applicable fees, costs and taxes.

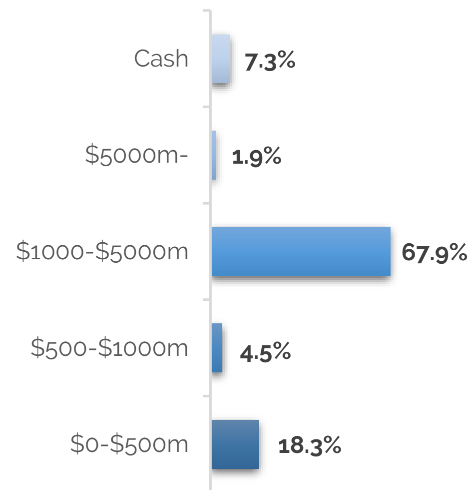
* Benchmark is the S&P/ASX Mid-Small Accumulation Index.

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.

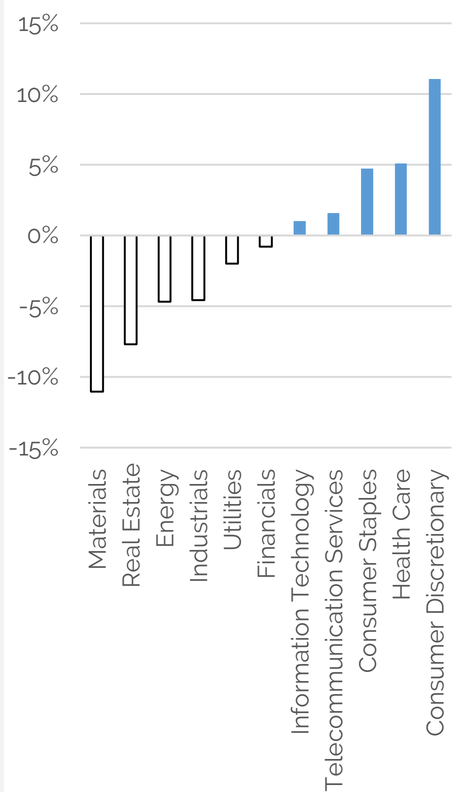
Top 5 Holdings

Company Name	% Portfolio
Healthscope	6.0
Navitas Limited	5.7
Bega Cheese Ltd	5.5
Fletcher Building	4.9
Platinum Asset	4.5
Top 5	**26.6**

Market Cap Bands



Active Sector Exposure



Commentary

The Spheria Opportunities Fund decreased by 5.4% in December, underperforming the Benchmark by 2.5%. For the year ending 31st December 2018, the Fund outperformed by 4.2%.

The benchmark fell sharply in the second half of year with very little discrimination. Several of our larger positions were subject to takeovers including Healthscope (HSO), Navitas (NVT), TradeMe (TME) and Greencross (GXL). Post balance date we note that Healius (HLS, formerly Primary Health Care) also announced a takeover bid from its major shareholder, Jangho Hong Kong. At this stage, it appears NVT, TME and GXL will complete with Brookfield also appearing very keen on HSO. The HLS takeover has yet to be agreed and faces potential FIRB issues that could flip it either way. We note HLS is trading at a material discount to the $3.25 indicative offer, which is below our fundamental valuation of $3.50. Like the board of HLS, we would like to see the offer price increased to better reflect value and the strategic merits of the company – it is the largest GP medical practice in Australia and the second largest pathology operator.

What went right last year? (top 3 contributors to return)

Sirtex Medical (SRX) – as most are aware SRX was the subject of a bidding war in early 2018. The lesson learnt is be greedy when others are fearful and buy when risks are skewed to the upside. In this case we bought SRX after the medical trials proved somewhat disappointing relative to extremely high expectations. When we initiated the position in the company it was essentially trading on 10x EBIT (free cash flow before interest and tax) with $120m of net cash in the balance sheet. Our research also indicated that the take-up of the product in the key USA market would unaffected by the weaker than expected trial results. We ended up selling before completion of the final deal given our concerns in relation to foreign review approvals for the Chinese buyer in the USA. This proved incorrect, nevertheless we nearly doubled our money on this investment.

Technology One (TNE) – had a perceived hiccup at its first half result in February 2018 that created a huge opportunity to increase our position in one of the best companies in the small cap market at a ridiculously low multiple. For whatever reason we believe the market does not adjust for cash (gearing) when valuing companies (TNE has ~$100m of cash) hence

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why we focus on enterprise values, EBIT multiples and free cash flow multiples. Clearly, the market has now re-engaged with TNE and it is now trading on much fairer multiple given the robustness of the business model.

HT&E (HT1) – had its "Alan Bond" moment when it sold Adshel for an incredible price. The company is now back to its core and highly cash generative radio business that has sound growth expectations through the cycle. It has paid a large fully franked dividend and is sitting on a strong cash balance with potential upside to cash levels from a resolution of a tax office dispute. Again, the market does not appear to be adjusting the valuation to reflect the cash position. HT1 will be in a position of strength, if the economy continues to deteriorate to potentially acquire assets at distressed prices.

What went wrong last year? (bottom 3 detractors to return)

Class (CL1) – suffered an extraordinary de-rate as growth in account additions slowed due to lower industry formations and the main competitor discounting to migrate desktop customers to its new cloud-based product. Taking a step back it is hard to rationalise the de-rate given when it CL1 listed it had only 90k accounts and has almost doubled that to 170k now. Given the retention rate is 99.2%, there is a highly recurring revenue stream that would be the envy of many. Unbelievably, despite nearly doubling its account base the share price is nearly back to its IPO price. That is very difficult to comprehend given the lifetime value of its customers. It feels like competitor antics and emotion are over-riding objectivity of the value equation at this point. A worst-case scenario is the industry declines as lower value accounts are closed, analogous to the ATO taking on lower value (<$6k) inactive accounts in the industry fund sector which will impact Link Admin (LNK). Incredibly, LNK has effectively re-rated (+15x EBIT) despite the documented ~10% headwind, whilst CL1 has de-rated to 10x EBIT on a "potential" scenario. With CL1 having over $20m of cash in the bank, we expect some form of capital management in due course. We believe the company has ample fire power to buyback a significant amount (up to $20m) of stock and make strategic acquisitions by utilising debt. We feel the next step for the industry is consolidation (organic growth having slowed) as smaller players lacking scale cannot be making money. The situation reminds us of Technology One (TNE) in 2000-03 when it fell over 80% to an all-time low of 20cps due to a slowing of its growth during the Dot Com bust – that company is now trading at over $6 per share.

Isentia (ISD) – after multiple profit warnings investors justifiably gave up on Isentia. Investors paid the price for management's poor strategic decisions of the past, technological evolution that is structurally changing consumption and monitoring of media and the frankly irrational pricing of its main competitor. The new CEO is dramatically re-shaping the business but is constrained by a weak balance sheet (FY18 net debt of c1.8x forecast EBITDA) and an onerous copyright contract. We believe the balance sheet could be addressed expeditiously by the partial or full sale of the Asian division, albeit the suspension of the dividend ought to be sufficient to deleverage the business in time. Our understanding is that a renegotiated copyright contract (not assumed in guidance) could also be favourable for ISD and present a headwind to its key competitor, Meltwater. Regrettably aggressive price competition from Meltwater is likely to continue hence the need to re-engineer/automate the back-end systems to drive efficiency in a lower pricing environment. At c4x EV/EBITDA however the market is pricing the business for failure. We think the situation isn't so dire and hence retain our position.

Bega Cheese (BGA) – the share price was trounced in the back part of the year due to difficult conditions in the Australian dairy industry that resulted in a profit downgrade in December. The severe drought has reduced overall milk supply putting upward pressure on the farm gate milk price (a key input for BGA's dairy products). We believe the retracement to be an overreaction to a temporary affliction. On a through the cycle basis we believe BGA is fundamentally inexpensive given the quality of its assets and management/board.

	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	• Up to 20% cash • Typically 5% - 10%
Expected turnover	30-40%
Style	Long only, risk aware
APIR	WHT0025AU
Minimum Investment	$25,000