



01:
Marcus Burns
portfolio manager
Spheria Asset
Management



02:
Matthew Booker
portfolio manager
Spheria Asset
Management

Servicing the small caps shortage

An established investment team believes its new LIC can deliver strong returns in the underrepresented small caps market

Come early December and Spheria Asset Management will be the latest fund manager to enter a listed investment company on the Australian Securities Exchange.

Spheria might well be the newest investment team to join the ASX when it launches the Spheria Emerging Companies LIC, but its two principals are hardly strangers to the Australian equities market.

Both Matthew Booker and Marcus Burns were previously the portfolio managers of the Schroders Smaller Companies and Microcap Funds before building out their own team at Spheria and becoming an affiliate fund manager of the Pinnacle Group.

Between them is more than 40 years' experience in the investment management industry and the duo is also well supported by analyst and trader Adam Lund, another Schroders alumnus.

It's this experience that Burns says will make the Spheria Emerging Companies LIC unique to the market.

"Spheria Asset Management was founded in April 2016. It's a three man team that's worked together for about five years. We comprise two portfolio managers and an analyst/dealer," Burns says.

The cash flow connection

What will truly differentiate the LIC though is the investment manager's pure focus on cash flow. It believes cash flow critically separates investments from speculation.

Burns says cash flow is particularly important when investing in small companies because it helps control risk in a small part of the market where it is potentially more volatile.

He explains if capital markets tighten and fall, investors can become skittish and become reluctant to invest in businesses that are going through a tough time – and banks also wax and wane in the credit cycle. Spheria doesn't want to be invested in companies relying on these external factors, Burns says.

Spheria also sees itself as an active value manager, and while there are several value managers in the market, many only focus on momentum, perhaps only looking for the next investment fad.

Booker says there are few LICs in the market that offer good quality opportunities across their portfolio in small caps. And it's a view held by the LIC's board, which also believes there is a shortage of capacity among small cap equity products focused on capital growth for Australian retail investors.

"We're looking for companies that generate good, sustainable cashflow, good returns are well managed and can deliver value over time," Booker says.

"Now that's quite different to what our peers offer. We think we can put together a portfolio over time that will deliver fantastic returns for clients."

Opportunities in small caps

Leading up to the Spheria Emerging Companies IPO, both Booker and Burns have plenty of insight on the Australian small and microcap markets. The pair already oversees investments for the Spheria Australian Microcap Fund, the Spheria Australian Smaller Companies Fund and the Spheria Opportunities Fund or about \$384 million in small cap and microcap equity portfolios.

Booker sees plenty of opportunity in emerging companies.

"Where we're finding opportunities is inflection points or points where companies are in a turnaround phase," he says.

"This means the market's written them off for whatever reason but the company has positive attributes. It still generates good cash flow, is well managed, generates good returns and we believe there's an inflection point opportunity in that stock."

He says companies like Sirtex, Blackmores and Vita Group are a few examples of companies at this inflection point.

Burns says Spheria's active and bottom-up approach doesn't target particular companies or sectors.

"At Spheria we don't invest in a particular type of company. We look at all companies and all sectors and we have stocks that have attributes that Matthew flagged earlier on, so these are stocks that do generate good cashflow, have good balance sheets and have good valuations," Burns says.

He adds the pair will also look closely at company management teams as it prefers management has skin in the game. This could be a founder or owner/operator style chief executive who has got a decent size of equity and thinks like a business owner, Burns explains.

"When we find people who act like owners we find they tend to allocate capital more rationally, they tend to control costs and they tend to move in a more intelligent fashion than others," he says.

Sizing up securities

Before any money is invested, Spheria will run its five-stage research and modelling process that effectively screens and assesses investment risk.

The LIC aims to model the majority of entities within its S&P/ASX Small Ordinaries Accumulation Index benchmark or about 200 entities at any given time. The portfolio managers may also look outside the benchmark for other ideas including pre-IPO securities and New Zealand securities.

Burns says the investment process will also include meeting with company management teams and other industry participants to gain a better understanding of how the entity operates.

He and Booker believe this is critical to gain an understanding of how each potential investment entity's business makes money, its culture and the business philosophy of key managers at that entity. This will include assessing the threat of new entrants and substitute products; and the bargaining power of suppliers and customers alike.

Finally the pair says the size of each position within the portfolio will be determined by its discount to valuation as well as other risk factors and the trading liquidity of the underlying security.

Given the LIC will be actively managed and benchmark agnostic, the portfolio managers don't have limitations in the investment strategy. The portfolio will typically hold anywhere between 20 and 65 stocks and the both managers will regularly review portfolio sector weights and thematic concentrations.

Once the LIC closes its IPO and lists on the ASX, Spheria says within six months it expects to be fully invested. The managers can also hold up to 20% of the portfolio in cash when attractively valued securities cannot be found.

The end game

The Spheria Emerging Companies LIC aims to outperform the S&P/ASX Small Ordinaries Accumulation Index. This will include the aim to provide investors with capital growth and income over the medium-to-long term by investing in predominantly Australian companies within the S&P/ASX Small Ordinaries Index.

Burns reiterates this will be achieved by investing in "good cashflow companies, good valuations and ideally a good management team that can allocate capital in a wise fashion."

An initial public offering for the Spheria Emerging Companies LIC is open until 24 November 2017. The company expects to raise up to \$250 million through the issue of up to 125 million shares at \$2 per share. **FS**



The quote

We're looking for companies that generate good, sustainable cashflow, good returns are well managed and can deliver value over time.



Watch the video
on www.fsitv.com