Geometrica Fund

Investor Newsletter – May 2020

We seek asymmetric investment opportunities informed by the coalescence of rigorous fundamental analysis and alternative data discovery.

The Geometrica Fund aims to deliver outstanding returns to unitholders via highly targeted investments in the global mid-cap equity universe.

Overview

Net of costs, the Geometrica Fund closed the month of May up +7.89%*.

The Fund's May return was driven by stock picking cast against the backdrop of markets that simply wanted to run hard, with the S&P/ASX200 Total Return Index and S&P500 Total Return Index advancing 4.4% and 4.8% respectively.

We ran quite conservative portfolio settings throughout May. While net exposure averaged around 75% for the month, stripping out the holdings of gold and gold-linked equities, adjusted net exposure sat at a modest 65% through May. Gross exposure never rose above 100%, with our view being that during the initial recovery phase of any crisis, you get punished for hugging your shorts too tightly.

Currency was an important factor and has been for the last few months for any Australian dollar denominated fund investing offshore. For most of the last two months we've heavily hedged offshore currency exposures back into AUD, which has minimized the negative impact of a depreciating USD.

Performance attribution at a stock level was largely concentrated in stocks which whilst directly affected by Covid-19, had used the crisis to strengthen their business models. The bounce in share price in a few of these has surpassed their falls in February and March.

We are enthused by what we own; a collection of idiosyncratic exposures where there is significant upside relative to downside. Positive asymmetric risk. Good diversification across industry.

Perspective

It is repetitive, but it is also true - we are finding opportunity at a single stock level far more than was the case pre Covid-19.

The main debate we see in equities seems to distil down to how far ahead should market participants look in their search for upside from the Covid-19 recovery.

This speaks to ongoing volatility around a path of uneven price discovery, but not a crash back down to the depths of March's lows. In our lexicon, "uneven price discovery" is code for opportunity.

Remembering that the market indices are just averages, there is a lot of dispersion and thus opportunity below the surface.

** Founders Class units – Lead Series. Small variations will occur between unit classes and series based on differences in timing and terms. Source: Mainstream Fund Services, the Fund's external administrator and calculation agent.*

HelloFresh (ticker: HFG.GR, €6.1bn mkt cap)

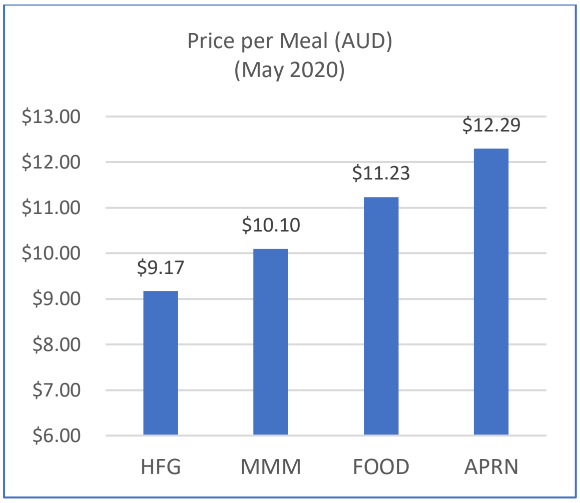
A material contributor for the Fund during May and indeed inception to date has been HelloFresh, the German based meal kit company that increasingly operates globally. HelloFresh is the #1 player in its category in the United States and for that matter Australia.

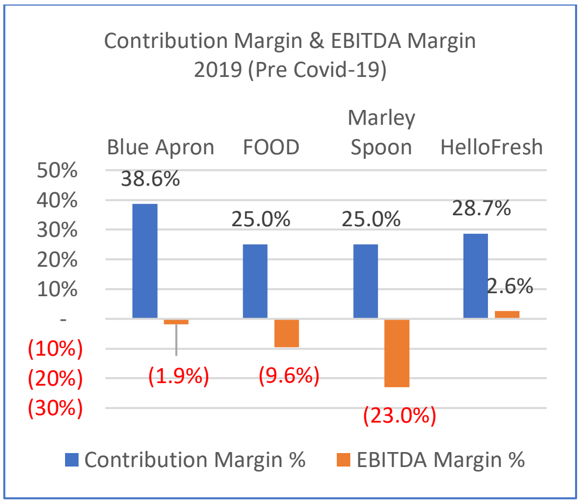
We found HelloFresh via a type of screen we run which highlights the capacity of a stock to expand its margins as it grows. We were a little surprised to learn that a number of Australian domiciled global funds own it, so we have absolutely zero claim in being first to the party.

When benchmarked to companies operating the same business model, HelloFresh compares extremely favourably. HelloFresh is actively investing its scale benefits progressively back into pricing.

This dynamic becomes circularly reinforcing. Lower prices drive more new customers and thus more scale. HelloFresh are not just growing the market; they are taking share, the economic equivalent of oxygen, from their competitors.

It is a winner-take all dynamic and HelloFresh have won the battle. As seen below, HelloFresh have the lowest prices yet enjoy higher EBITDA margins than their competitors.

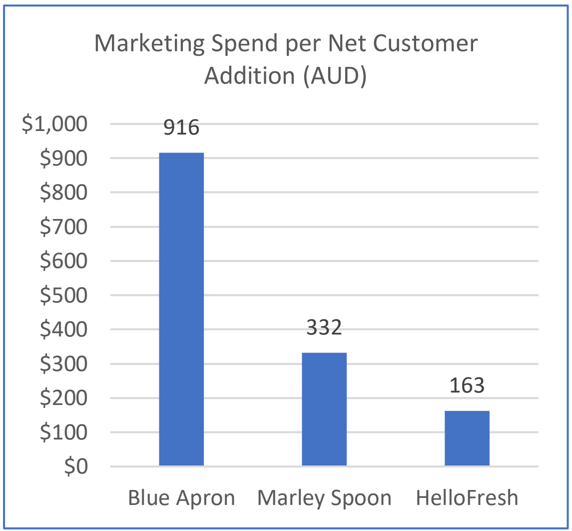




Source: Company websites and financials; Geometrica. Contribution margin is defined as sales less cost of goods sold and direct cost to serve.

It is also easier to sell a great value proposition.

When viewed through the lens of buying the constituent ingredients at your local supermarket, HelloFresh is typically *materially* cheaper than that alternative.



Source: Company financials; Geometrica.

HelloFresh are also better than the opposition within their business model vertical when it comes to customer acquisition.

Which drives better returns and a capacity to price lower. A self-reinforcing loop.

Having been one of our top five holdings and having punched cleanly through what we thought the market should pay, we sold the entire position as the month drew to a close.

We continue to monitor this stock very, very closely.

Fortescue Metals Group (ticker: FMG.AU, A$45.5bn mkt cap) was a stock we alluded to in the last newsletter. We've run a sizeable position in iron ore across three separate stocks with Fortescue being the largest.

The humbling lesson from covering commodity stocks for several years is that the ideal investment candidate needs to see rising commodity prices relative to expectations (or make a major discovery). Given commodity prices are the single most important driver of earnings, the detail beyond this is to an extent nuance around where to seek the best exposure.

The equity market continues to focus on supply disruptions to iron ore giant, **Vale** (ticker: VALE.US / VALE3.BZ, US$55.8bn market cap), as the key driver of the shift in supply and demand dynamics feeding into higher iron ore prices.

This is true in the very short-term given Covid-19 is reportedly wreaking havoc with Brazilian iron ore exports, but we are equally enthused by the demand surge coming down the pipeline in China. We would simply reiterate that China is not a conventional economy. It can pay to listen less to official pronouncements and spend more time following the money, or in this case the credit surge, which is already rapidly reflating property linked data such as land sales and apparent steel consumption.

Domain Holdings (ticker: DHG.AU, A$1.9bn mkt cap)

We discussed our position in Domain in the last newsletter, although somewhat obliquely. The stock was a material performance contributor in May, but we think it has a lot further to run.

Optically the temptation is to view all the stocks that swooned in February and March as candidates for share price mean reversion.

But the best opportunities are when an adaption occurs that improves the forwards earnings trajectory. This is where Domain comes in.

We think Domain is a coiled spring given the structural change in forward revenue and cost profile, and that consensus margin forecasts are too low by quite a margin.

Sezzle (ticker: SZL.AU, A$520m mkt cap)

Sezzle continues to catch a bid as we write, hitting fresh share price highs. For a brief period we also owned **Afterpay** (ticker: APT.AU, A$14.0bn market cap), the largest player in the buy now, pay later sector, but threw it to the wolves after it ripped through $40 and past our estimation of what the market might pay. We were a little premature in that assessment, with the stock now over $50/share. We have sellers regret, but we're also scratching our heads at the same time. Markets can be humbling.

What hasn't worked

We entered a few positions post recapitalisations where there was upside tempered by dilution, but perhaps exited too early only to see some of them continue to run to a point where the share prices seemingly imply full recovery to pre Covid-19 conditions in deeply affected sectors. Seller's remorse but we have to stick to the process. Chase the market and you just chase your tail.

We've also missed the rebound in a few names we jettisoned as Covid-19 really smashed into equity markets in February. Things moved fast but it is hard not to feel a little foolish or at least miffed at missing opportunities like Shake Shack and Micron when they were trading at knock down prices.

The silver lining is that we did use the sell off to effectively high grade the portfolio. Around 40% of our exposures would tick the box as "compounders", that is, businesses that have the capacity to grow revenue and margins, driving outsized growth in earnings in the process. We just wish we'd collected more of them during that brief period of opportunity when it felt like the world might be ending.

Short book

As we said above, we deliberately ran very low short exposure over April and May. No doubt there were profitable shorts to be found, but the more attractive asymmetry lay on the long side of the ledger through those months.

Perhaps the opportunity set is now tilting to become more evenly balanced. In the closing days of the month we initiated short positions in three stocks. Two of them are market darlings.

Somewhat counter intuitively, we don't normally wind up shorting "bad" companies. We're always just looking for ones that are mispriced, where earnings are likely to materially deviate from consensus expectations. Which means the best shorts are those companies the market views as "good", as reflected in their valuation, where consensus earnings forecasts are just plain wrong.

We don't normally name or showcase our short side work in newsletters, but perhaps it would be good to go through a thesis or three. *Before* they play out so there isn't the normal positive selection bias on our part. It's a riskier pitch, we make mistakes, but at least the experiment would offer a real-time perspective, and the errors should average out over time to comport with what kind of value we are realistically able to add.

Open for subscriptions

The Geometrica Fund is now open for subscriptions.

As ever thank you for your trust. We're working hard to pay that back in investment returns.

Hopefully in spades.

Geometrica

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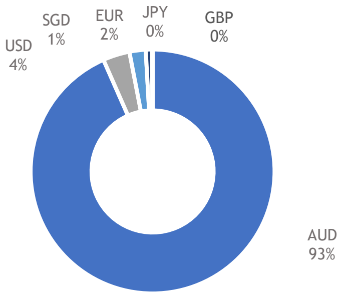
Fund overview (Alpha Units)

Fund	Geometrica Fund	Investor Eligibility	Wholesale only
Structure	Wholesale unit trust	Minimum Investment	A$250,000
Mandate	Global long short Mid-cap focus	Fees	1.5% management (+GST) 20% performance (+GST)
Gross exposure range	0 - 200%	Benchmark	RBA Cash Rate
Net exposure range	up to 100%	High water mark	Yes
Single stock long limit	15% at cost	Liquidity	Monthly
Single stock short limit	5% at cost	Admin & custody	Mainstream Fund Services
Buy / Sell Spread	Nil / 0.25%	Platforms	Ausmaq

Currency allocation



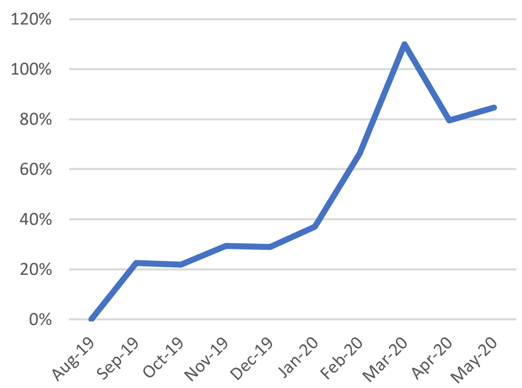
Asset allocation

Country	Long	Short	Gross	Net
Australia	37.3%	(3.5)%	40.8%	33.7%
United States	38.2%	(1.2)%	39.3%	37.0%
Asia	2.5%	0.0%	2.5%	2.5%
Europe	0.9%	(1.1)%	2.0%	(0.3)%

Investment performance (net)

	Founder Lead Series 2019	Founder Lead Series 2020
Jan	-	-1.3%
Feb	-	-0.3%
Mar	-	-5.2%
Apr	-	2.4%
May	-	7.9%
Jun	-	
Jul	-	
Aug	-	
Sep	1.1%	
Oct	0.8%	
Nov	0.1%	
Dec	-1.6%	
Total	0.5%	3.1%

Gross exposure



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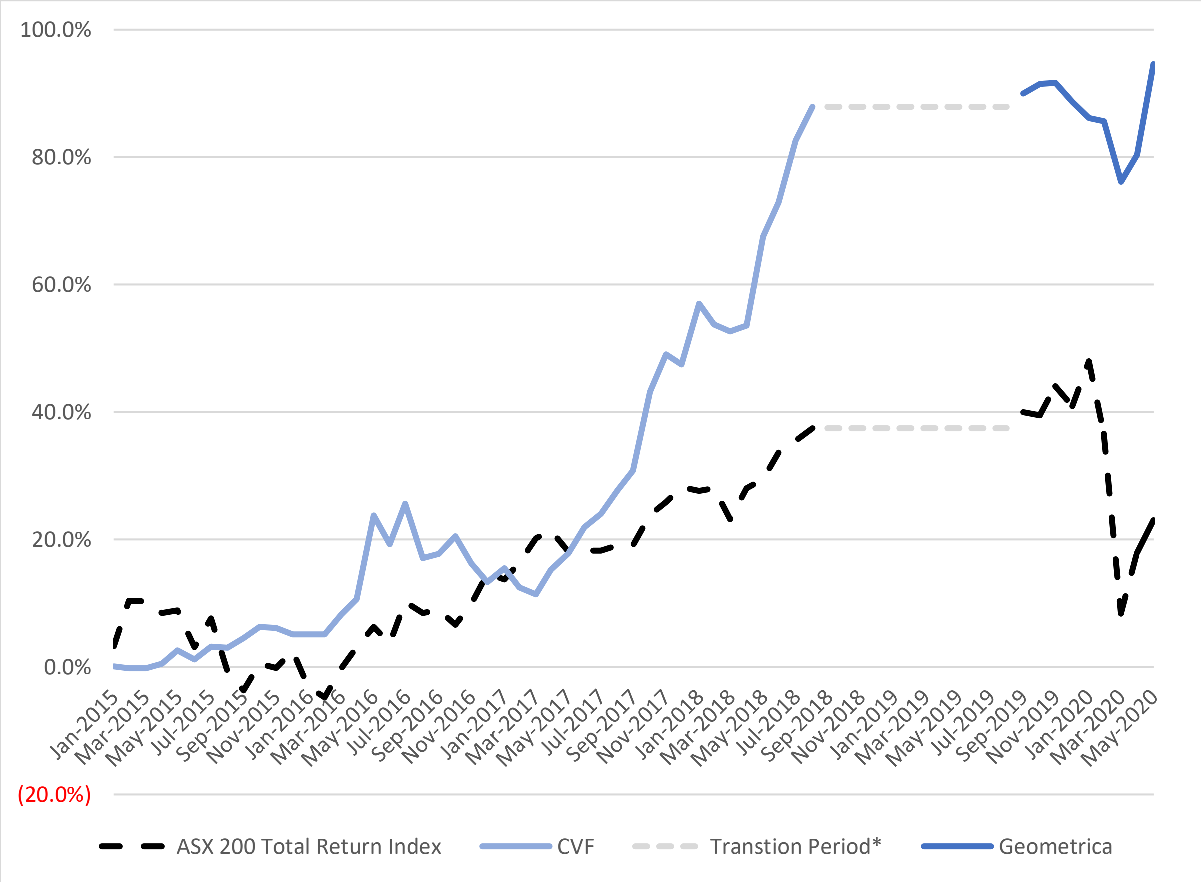
Manager performance history



*** Manager left CVF in Sept 2018 and began Geometrica in Sept 2019**

NB: Performance period is from 5 Jan 2015 – 31 May 2020. Performance is net of all fees