Geometrica Fund

Investor Newsletter – August 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.

Investment performance (net)

As at 31 August 2020	1 month	6 months	12 months	Since inception (annualised)
Founder Lead Series*	+3.5%	+22.4%	+21.0%	+21.0%

Overview

Net of costs, the Geometrica Fund closed the month of July up +3.52%*.

August 31st marked the Fund's anniversary, with the first twelve months of operations delivering a net return of +21.0%*.

A key contributor to this month's performance was our holding in IDP Education. Our iron ore positions continued to contribute to performance.

Key detractors from performance were positions in Treasury Wine Estates and VIP Shop Holdings.

Treasury Wine Estates (ticker TWE.AU, mkt cap. A$6.5bn)

We had built a position in TWE some months ago and were on the way to being rewarded for this when a better than expected annual earnings result saw the stock rise 12% on the 13th of August.

The basic logic had been that as China was TWE's largest profit pool and China had exited Covid-19 first, TWE should start to see recovery in its most important market. TWE was also telegraphing to the market its intention to spin off its Penfolds business, where growth was being driven by increasing Chinese consumption of premium wine.

Three days after the positive earnings print an anti-dumping inquiry into Australian wine imports was announced in China. TWE's stock price fell 14% on the day.

The irony is that China is TWE's highest margin market, with those high margins being driven by high prices. Penfolds is the major driver of earnings for TWE in China with a heavy skew to premium pricing. It might be hyperbole to imagine the "dumping" of Grange on the unsuspecting Chinese wine cognoscenti at premium prices, but only just.

From announcement of the Chinese inquiry, a period of 60 days must elapse before any countervailing tariff is levied on Australian wine imports by China. That tariff might be as high as 80%, which would knock the absolute stuffing out of TWE's earnings. TWE and Penfolds make

* *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.*

some good wine but if tariffs result in a doubling of prices in China then volumes must suffer for a product that is not 100% demand price inelastic. You start to get a lot of quality competition from old and new world producers within China with such a large effective price increase.

A large tariff would also see the Penfolds spin off almost certainly shelved, killing off a key part of the investment attraction.

And so we sold the position. The tariff outcome is difficult to predict.

Should Australia genuflect on all matters deemed important by China to China, then a tariff might be avoided altogether or prove fleeting in application.

Should Australia assert sovereignty over Australian political discourse then a high tariff might be applied for a long period of time.

Vipshop Holdings (ticker VIPS.US, mkt cap. US$11.1bn)

VIPS has been a recovery play. The company is an online flash retailer of branded apparel in China and has of late seen strong sales and margin recovery after changing its strategy a few years back.

We invested because we saw data that was highly supportive of a strong impending earnings result and VIPS was leveraged to recovery in Chinese consumption post Covid-19. Apparel as a consumer segment had slowed in lock down and was clearly recovering.

The earnings result was as good as we were hoping for and just prior to market open on the day of earnings the stock was matching up around 5%.

Then came the utterance of next quarters sales and margin guidance which was much weaker than expected and the stock shed 19%.

Delving into the situation it appears that management have concluded the only way for them to sustain top line growth is to crunch pricing down. This is emblematic of an intensely competitive environment. The margin accretion that we could see arising from an improvement in VIPS logistics model was thus being fully surrendered to consumers as a policy to continue strongly growing the top line. We had thought both goals were possible (sales growth and net margin accretion via a combination of lower gross margins but incrementally lower logistics costs offsetting this) but for now at least management will cleave to growth.

We exited the position. Because we were bluntly wrong, our thesis was “busted”. So as a matter of simple risk management we exit. We have learned over the years that thesis drift; where an investment that doesn’t work out is justified by changing the underlying thesis; can be very costly.

IDP Education (ticker IEL.AU, mkt cap. A$5.4bn)

IDP was a material positive contributor to performance during the month.

IDP has two businesses; IELTS (International English Language Testing System) which is one of the benchmark English language testing systems facilitating foreign student admissions to English language university courses, and an international student placement business whereby foreign students are assisted in finding and enrolling at suitably aspirational universities. The former is a quasi-monopoly and the latter was growing like a weed with extremely high incremental margins before Covid-19 hit. India is a key driver of growth across both businesses.

When IDP reported its earnings in August, two things became clearer. First, the balance sheet and liquidity profile are in excellent shape. Which is to say, IDP can definitely weather the Covid-19 storm. Secondly, it is also clear there is significant pent up demand for IDP's services. Come an opening up of overseas study, demand for IDP's wares is going to be extremely strong.

We think IDP will surprise in the years ahead in growth and margins. Because of its secure balance sheet position, we think the market is prepared to pay a price for that now, in anticipation of the strong upside to come.

Portfolio positioning

Covid-19 has in reflection been a singularly polarising investment opportunity. Either you owned or bought beneficiaries of work from home ("**wfh**") or you suffered poorer investment returns for not doing so.

With tech there are underlying structural drivers. Large tailwinds. For example, it is not an exaggeration to assert as one famed technology fund has, that software is literally "eating the world". The question for us is how far into the future do you want to pay for that?

Covid-19 has resulted in an additional layer of event driven earnings being enjoyed by many beneficiaries of wfh.

The question isn't just: "what happens when we have vaccines?"

It is also: "what happens when we anniversary Covid-19?". All else being equal you'd expect a slowing in growth on a larger base of earnings for a lot of wfh beneficiaries driven by simply cycling a tougher comparable period, but it is of course a case by case assessment.

This has all occurred at a time when some valuation multiples challenge credulity and invite comparisons to the last tech boom.

We are aware of some instances of deep reflexivity in the listed tech space. We are short one of them, in modest size. We are also aware of business models that simply won't work in a world that is less indiscriminate in its fervour for tech stocks at any price.

We cannot tell if we are on the edge of a tech bubble busting, but we're alive to that possibility. Things might just keep on going for quite some time.

For now its simply too early to tell.

The end goal though doesn't change. Find stocks that are mispriced, likely to see that market inefficiency corrected in a reasonable period of time and own them (or short sell them) as the case may be.

Gary, James & Ben.

14th September 2020.

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Fund overview (Alpha Units)

Fund	Geometrica Fund	Investor Eligibility	Wholesale only
Structure	Wholesale unit trust	Platforms	Ausmaq
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	Administration & custody	Mainstream Fund Services
Buy / Sell Spread	Nil / 0.25%		

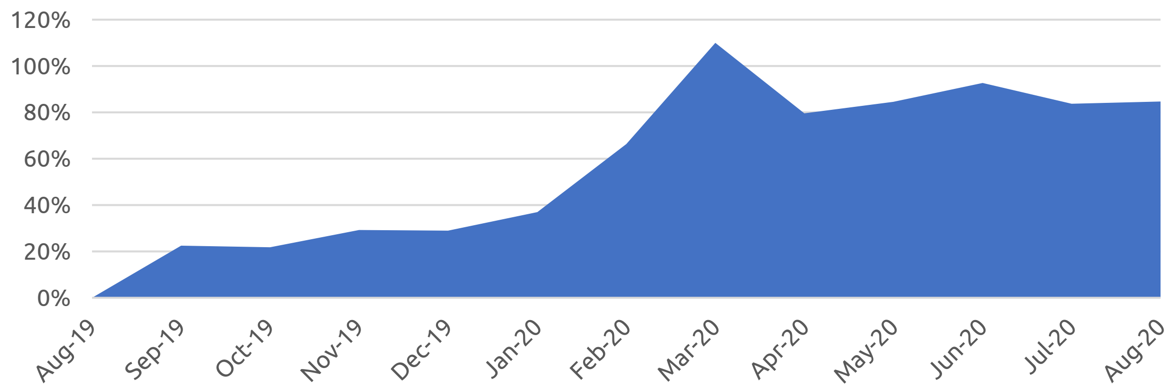
Investment performance (net)

	Founder Lead Series 2019	Founder Lead Series 2020
Jan	-	-1.3%
Feb	-	-0.3%
Mar	-	-5.2%
Apr	-	2.4%
May	-	7.9%
Jun	-	3.0%
Jul	-	9.5%
Aug	-	3.5%
Sep	1.1%	
Oct	0.8%	
Nov	0.1%	
Dec	-1.6%	
Total	0.5%	20.4%

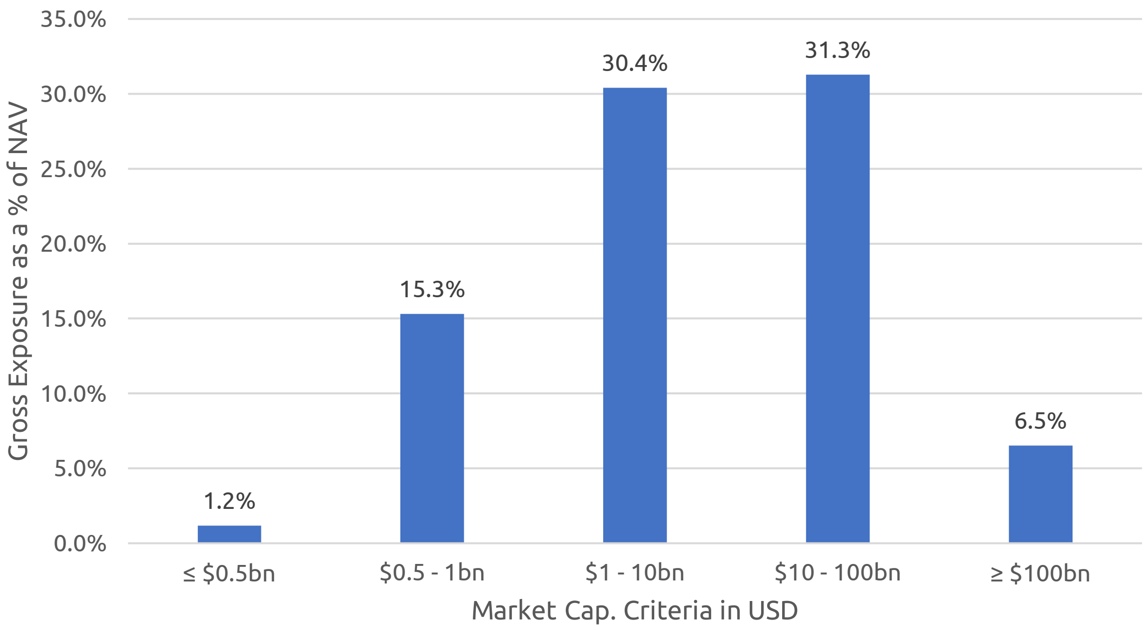
Asset allocation

Country	Long	Short	Gross	Net
Australia	16.0%	(6.7)%	22.7%	9.2%
Americas	37.6%	(0.9)%	38.4%	36.7%
Asia	15.0%	0.0%	15.0%	15.0%
Europe	8.6%	0.0%	8.6%	8.6%
Total	77.1%	(7.6)%	84.7%	69.5%

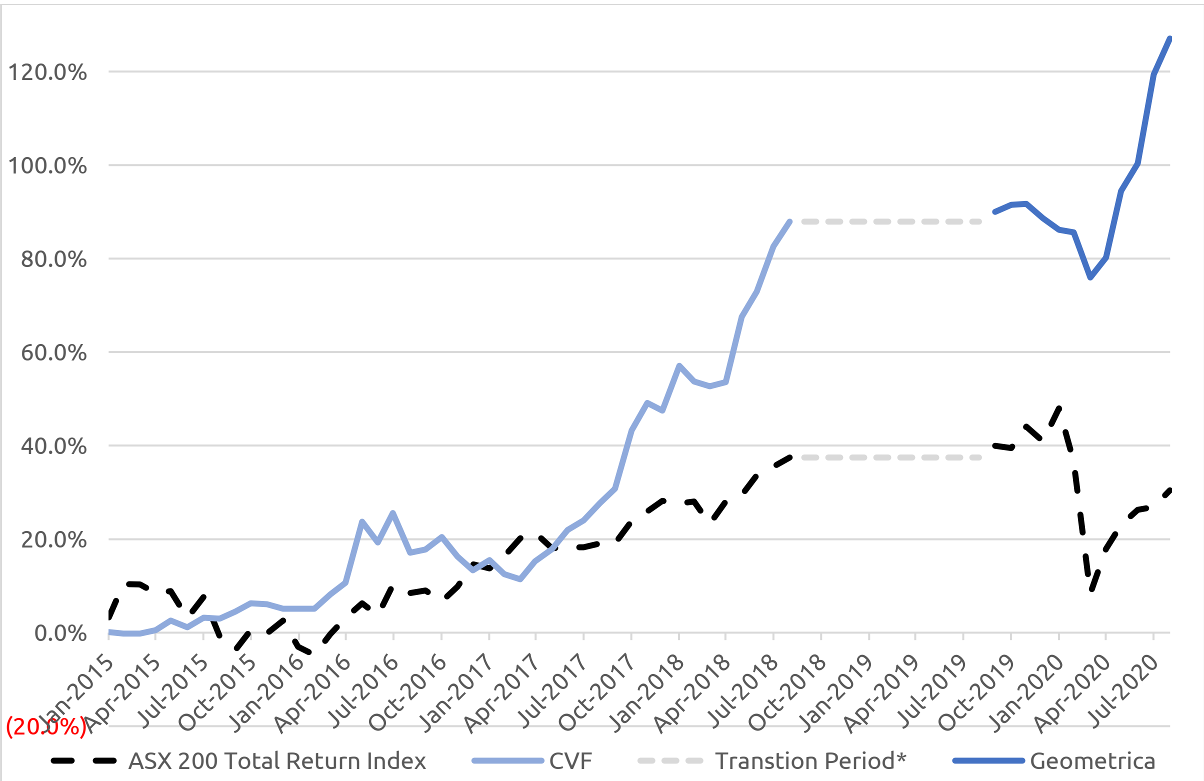
Gross exposure



Gross exposure by market capitalisation



Manager performance history



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

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

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The Fund is not suitable for all investors. Investing in any security or fund involves significant risk. The price of any security or fund may decline as well as rise.

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