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)

31 Aug 2021	Inception pa	CYTD	FYTD	12 months	6 months	1 month
Founder[1]	+20.46%	+15.32%	+1.24%	+19.97%	+3.25%	+2.64%

Performance Asymmetry: Uncorrelated Outperformance

Source: Mainstream, ASX Announcements, Geometrica and Bloomberg. Performance is after all fees, from Jan 2015 (excluding the period of Sep 2018 – Aug 2019; Manager left CVF in Aug 2018 and began Geometrica in Sept 2019). MSCI = MSCI ACWI (AUD).

OVERVIEW

Net of all costs and fees the Geometrica Fund returned +2.64%* for August 2021. Inception to date performance stands at +20.46% per annum, with calendar year to date at +15.32%.

Positive contributors during the month included long held positions in Entain and Domain. One of our Asian positions was also a major contributor after advancing over 15% in the month. We also bought into another US gaming stock (as foreshadowed in our last letter).

A collection of short positions in the iron ore complex added 30bps.

Autodesk, Micron and Uber were incremental detractors from performance.

[1] *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.*

PORTFOLIO

We have increased our Asian exposure in recent months but own no Chinese stocks. Asia as a region contributed almost 60% of our returns in August.

The increase in portfolio weighting in Asia is a result of scaling up several names we have owned for some time and adding a few names that we have actively stalked for many months.

A Japanese stock within our top 10

One of our stocks in Asia, which advanced by over 10% during August, is a name we have been following for well over a year.

This company has a product whose usage we track in near real time. We think we are in a definite minority in doing this. Whilst this product's revenues are material and its margins very high, the associated earnings are reported within a large segment which has the effect of obscuring the products visible growth to readers of the financial statements.

We are seeing volume growth for this product advance to such an extent that the company is struggling to keep up with supply. Rapid demand growth is coming from North America which appears to obscure it to coverage analysts due to geographic isolation but when the company last reported earnings, segment reporting showed a noticeable tilt in revenue mix towards North America. This perplexed several coverage analysts. We have subsequently confirmed our non-consensus views with management. A product refresh later this year is likely to further drive adoption in our view, setting the stock up for material earnings beats relative to consensus expectations as proxied by sell side analyst earnings forecasts. The stock is in our top 10 long holdings. We won't be naming it lest we create competition for ourselves and disadvantage our fellow investors by doing so.

A Western champion in Japan

Another stock we have owned intermittently over the last two years sources a majority of its earnings outside Japan under a brand few users associate with Japan.

Coverage analysts characterise this stock as a cyclical, but that perspective obscures an underlying transformation in progress. This business is a structural winner. We can see progressive growth in mix over time of quality revenue as the company continues to heavily reinvest via the profit & loss statement, compressing its near-term margin profile and earnings power in the process.

The industry exhibits a cost curve related to scale. A global comparison of competitors confirms our view that the company is under earning, we think in order to grow its market share which results in fractionalisation of fixed costs to the point it may be able to price at a level where it, and only it, can be profitable. Longer term pricing power should accrue in spades.

Management is particularly coy around margins and earnings guidance and have a record of serially under promising and over delivering.

Autodesk (ADSK.US, mkt cap US$61.4bn) fell 3.4% in August and is down another 8% month to date in September as we write.

Market expectations were dashed around the forward trajectory of cashflow when guidance noted very strong growth into 2022 but then a transitory dip in 2023 as customers on three-year contracts who typically paid-up front are rolled onto single year contracts. Cashflow then reaccelerates after 2023 and continues to grow. The miss or surprise however is in phasing, *not* aggregate quantum.

We were aware of enterprise customers phasing and accurately predicted the 2022 acceleration but were unaware of another layer of small multi-year customers who are being pushed off these discounted plans and onto annual plans subject to annual price increases. We were thus wrong in this detail.

But mathematically, this is a phasing issue with the PV of cashflow involved changing by less than 1%. This is a storm in a teacup that is obscuring a bigger picture.

To be clear, we would dump the entire position in a heartbeat if we thought thesis drift was at work here. When we own a stock for a reason that is no longer valid, we sell. In Autodesk's case, we have bought more.

We have been focused for over a year now on Autodesk's monetisation of a long tail of non-compliant users, because the size of this prize is massive at roughly 3x the size of the compliant base. Sell side analysts are pessimistic on the opportunity, but after studying analogues we are not. Hence the potential positive return asymmetry on offer.

Autodesk has now announced what it calls Tokens. Tokens are a way to monetize the long tail of non-paying users, which Autodesk pegs now at *15 million*. Even partial monetisation would be material. The company has confirmed Tokens form no part of earnings guidance.

This is usage-based pricing. For many other stocks in the sector usage or consumption-based hybrid pricing models have driven an acceleration in revenue growth and a concomitant valuation rerating. Autodesk's user profile lends itself to this hybrid revenue model.

Designed to encourage non-compliant users to pay a small amount to be compliant, our estimation of relative pricing is 3 to 1 versus a fully paid seat. In essence, no full subscription customers will down shift but many non-compliant users, a very large number of which are within the current user base, will use Tokens. And because Autodesk has transitioned to the cloud, non-compliant users are able to be tracked and pushed into compliance via Tokens, or ultimately just turned off.

MACRO

Chinese technology sector shifts

A series of regulatory actions taken against Chinese technology stocks in recent months was characterised by some as a regulatory catch up and thus an opportunity for blanket investment in the sector.

It is true that Jack Ma, China's richest man and the founder of Alibaba, China's largest technology company was at the epicentre of a regulatory crack down. In April 2021, Alibaba was hit with a whopping ¥18bn fine. A month prior a dozen Chinese tech companies had been fined for breaching anti-monopoly rules.

The starting point for this crescendo of regulatory activity appears to have been in October 2020, when Jack Ma delivered a speech that was scathing in its criticism of Chinese state-owned banks and banking regulators.

A short time after Ma's speech, the IPO of Jack Ma's Ant Group, set to be the largest ever, raising almost US$35bn, was axed by the same Chinese regulators he'd critiqued. Given this IPO was to be exclusively on the Shanghai and Hong Kong exchanges, and excluded listing in New York, its cancellation was even more significant.

Ant Group is a financial payments and alternative lending platform rapidly disintermediating Chinese banks in consumer finance. Ant Group would have had a market capitalisation of over US$300 billion.

Years ago, Ant Group used to be called Alipay and Alipay used to be a wholly owned subsidiary of Alibaba.

Back in 2011, Alibaba was a private company whose major shareholders included Yahoo and Softbank. In 2011 Jack Ma, Alibaba's founder, transferred 100% of an Alibaba subsidiary called Alipay into a company he controlled, ostensibly to "*protect it*" from a change in PBOC regulation that would limit foreign ownership levels.

Jack Ma's concern must have been truly urgent because he didn't seek the approval of Alibaba's shareholders before he transferred Alipay away from them. Yahoo's 3Q 2011 financials detailed a Framework Agreement that reads like a reparation plan for Alipay's transfer out of Alibaba and away from Yahoo, which at the time owned over 40% of Alibaba.

Ma's speech in October 2020 must have smacked of hubris to some in the audience. Ma became immensely wealthy in part from his unique embrace of the Chinese regulatory system.

The assault on China's tech titans goes beyond regulation. Didi, the Uber of China, is having its shareholding structure altered to accommodate the introduction of state linked investors after regulators banned it from accepting new users. Ant Group is suffering a similar fate. And the inclusion of state linked individuals in governance structures is also occurring.

The regulatory action is not confined to the Chinese technology sector. It has spread out to encompass social mores and other sectors of the economy, most notably the property sector.

Common Prosperity

Enveloping all of this is the ideology of Common Prosperity, increasingly spoken of by President Xi. This is a phrase used previously by Mao and Deng.

Deng said that to open the Chinese economy the party would have to let some people get rich first.

But perhaps this was supposed to be a means to an end, not an end in itself.

One noteworthy commentator has likened President Xi's embrace of Common Prosperity as policy remorse, where the excesses of capitalism are seen to have gone too far and now require correction.

In other words, this may be a pivot to the left, not just a regulatory catch up. And the CCP may increasingly involve itself in the Chinese economy in the years ahead.

We can see the state reasserting its role in the restructuring of Didi, Alipay and others, where state actors enter the share register and the board room.

The policy remorse and a desire for social equity is arguably laudable, depending on where your values and your belief in free markets sit. It will make investing in this market more nuanced, but that may confer an advantage on those willing to do the work to understand what sectors the CCP wishes to see grow in reach and profitability.

China property

Back in August 2020 the PBOC and MOHURD introduced new regulations dubbed "*the three red lines*" designed to curb leverage in the Chinese property sector.

The actions of the PBOC and MOHURD make sense in the context of limiting the extent to which debt fuelled speculation in housing is crowding out other more productive areas of the economy.

Evergrande, a massively leveraged property developer making headlines globally is the poster child of the kind of financial excesses that the *three red lines* policy is aimed at.

You would be hard pressed to find a major economy in which the property sector had a higher share of GDP, household investment or household debt than China.

Indeed, over recent years many people have claimed a bubble exists in Chinese residential property[2]. As ever the existence or size of a reflexive asset bubble is less relevant to us than the nature of credit flows feeding it.

Iron ore

We have been short iron ore producers in small size due to our work on Chinese property, material markets and Chinese environmental policy.

Ironically recent falls in iron ore have more to do with Chinese environmental policy limiting steel production for the remained of 2021 than any downturn in steel demand. But that may be coming.

[2] See for example: "*Peak China Housing*", Rogoff & Yang, 2020.

If regulatory action slows the activity of China's property developers, then it follows that steel demand will be impacted.

Of the 1 billion tonne growth in global crude steel production from 823 million tonnes in 2001 to 1.8 billion tonnes in 2019, 84% of this was due to China.

Similarly, of the 680 million tonne growth in Australian iron ore exports from 157 million tonnes in 2001 to 838 million tonnes in 2019, 96% of this growth was due to China.

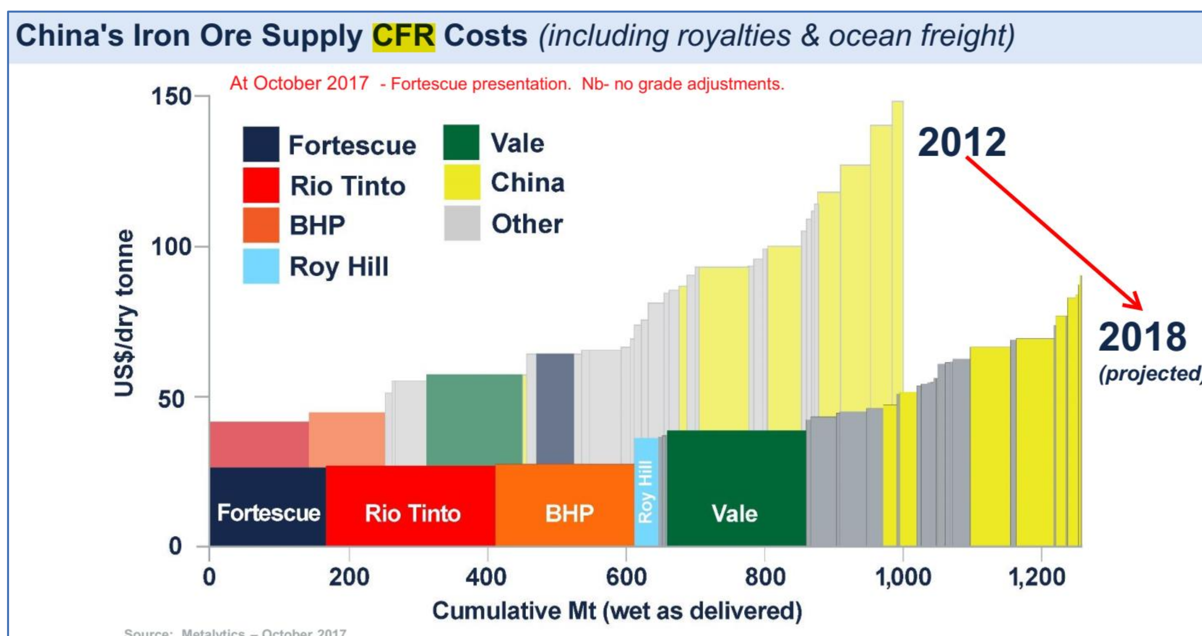
The heuristic is that 60% of Chinese steel production is construction related, 20% is infrastructure and 20% "other".

There is an obvious linkage between Chinese property construction activity and iron ore demand.

The situation is very different to what it was back in 2008 or 2014. The big 4 (BHP, Rio, Vale and Fortescue) literally have no debt net of their cash holdings today, unlike in prior episodes of iron ore price weakness. The same financial vulnerability is not there that once was.

What has changed is the shape of the iron ore cost curve. In a typical commodity market, the supply costs of the last marginal mine required to supply demand determine pricing.

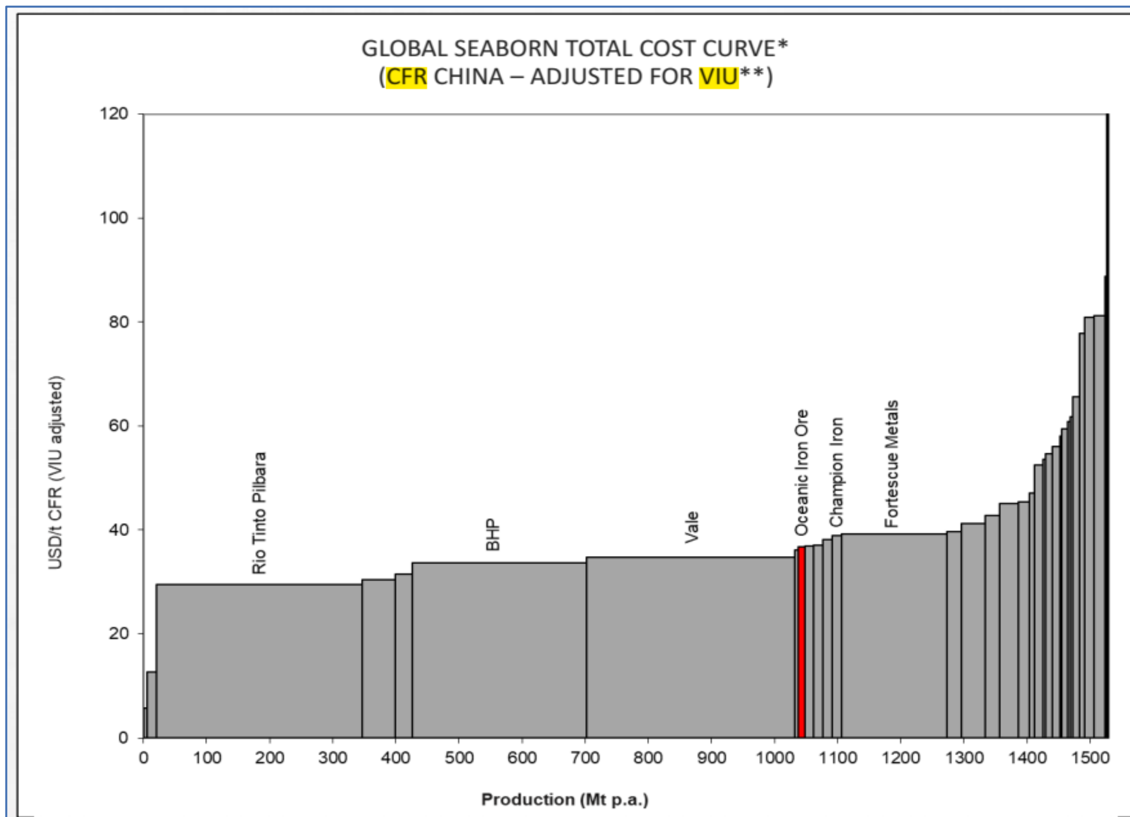
The chart below from Fortescue is out of date by a few years but illustrates the point. The iron ore cost curve has shifted down and out to the right, meaning a proportionately smaller wedge of high-cost supply, coupled with the credit driven construction demand that we first saw back in April 2020, has been crucial to the maintenance of very high iron ore price levels.



Source: Fortescue Metals Group Limited

The cost curve below is both more recent and adjusted for iron ore grade, that is the iron content.

The cost curve below shows that a very small displacement of demand would see cost support for prices “slide” down the curve from $100 to $40, depending of course on the size of any demand contraction.



Source: Oceanic Iron Ore Corp.

Our work on the construction materials commodity sector continues. We expressed some of our views more meaningfully in several trades after month end that we look forward to commenting on next month.

FUND OVERVIEW (ALPHA UNITS)

Fund	Geometrica Fund
Structure	Wholesale unit trust
Mandate	Global long short Mid-cap focus
Gross exposure range	0 - 200%
Net exposure range	up to 100%
Single stock long limit	15% at cost
Single stock short limit	5% at cost
Buy / Sell Spread	Nil / 0.25%
Investor Eligibility	Wholesale only
Platforms	Ausmaq, Hub24
Fees	1.5% management (+GST) 20% performance (+GST)
Benchmark	RBA Cash Rate
High water mark	Yes
Liquidity	Monthly
Administration & custody	Mainstream Fund Services

INVESTMENT PERFORMANCE (NET)[3]

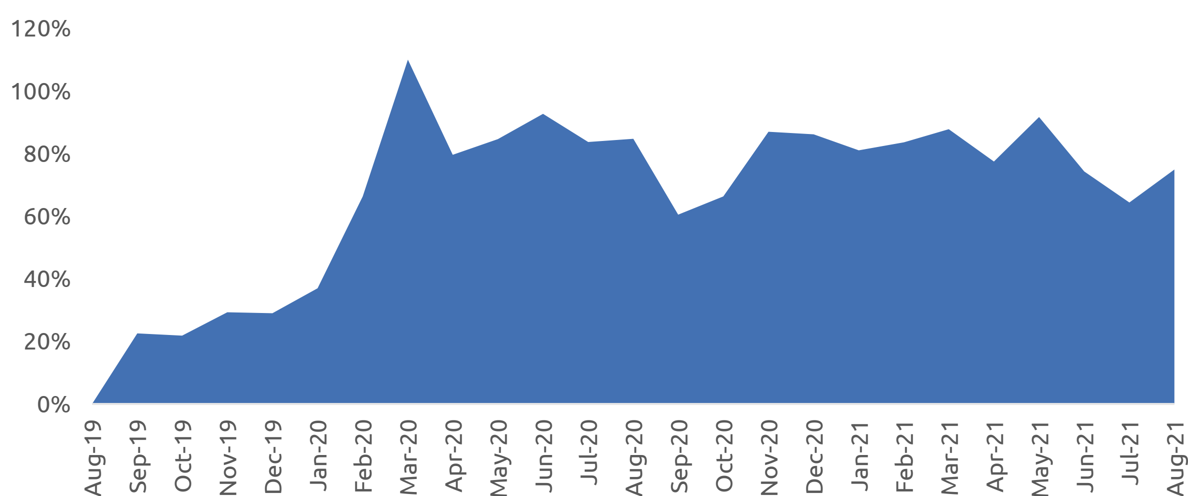
	2019	2020	2021
Jan	-	-1.3%	4.5%
Feb	-	-0.3%	6.9%
Mar	-	-5.2%	1.2%
Apr	-	2.4%	3.0%
May	-	7.9%	-1.5%
Jun	-	3.0%	-0.7%
Jul	-	9.5%	-1.4%
Aug	-	3.5%	2.6%
Sep	1.1%	-1.4%	-
Oct	0.8%	-1.4%	-
Nov	0.1%	4.8%	-
Dec	-1.6%	2.0%	-
Total	0.5%	25.2%	15.3%

[3] *Founder Class units – Lead Series*

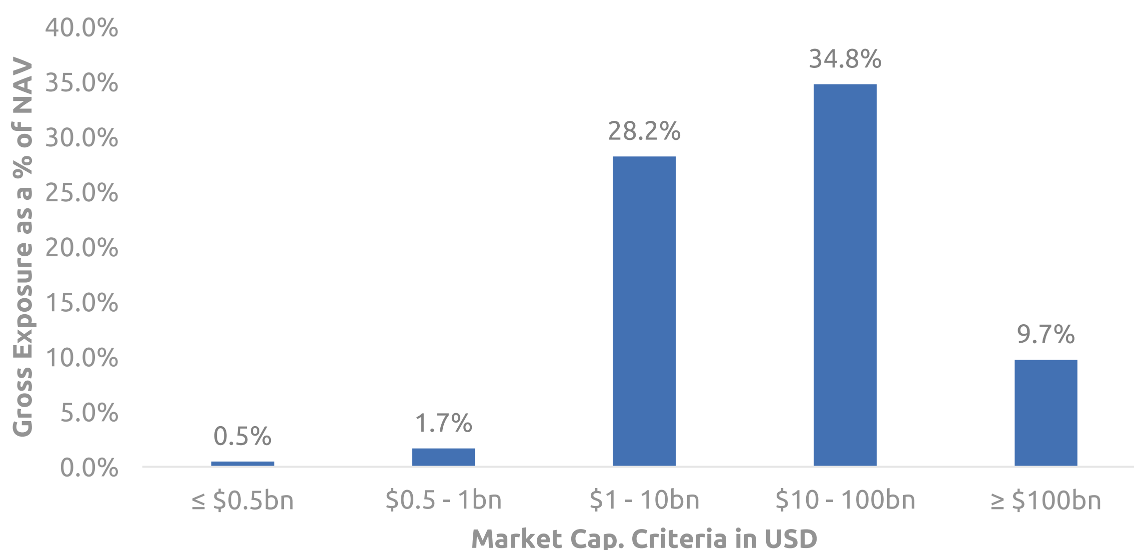
ASSET ALLOCATION

Country	Long	Short	Gross	Net
Australia	16.0%	(1.7)%	17.8%	14.3%
Americas	25.7%	(1.4)%	27.1%	24.4%
Asia	22.7%	0.0%	22.7%	22.7%
Europe	7.3%	0.0%	7.3%	7.3%
Total	71.8%	(3.1)%	74.9%	68.7%

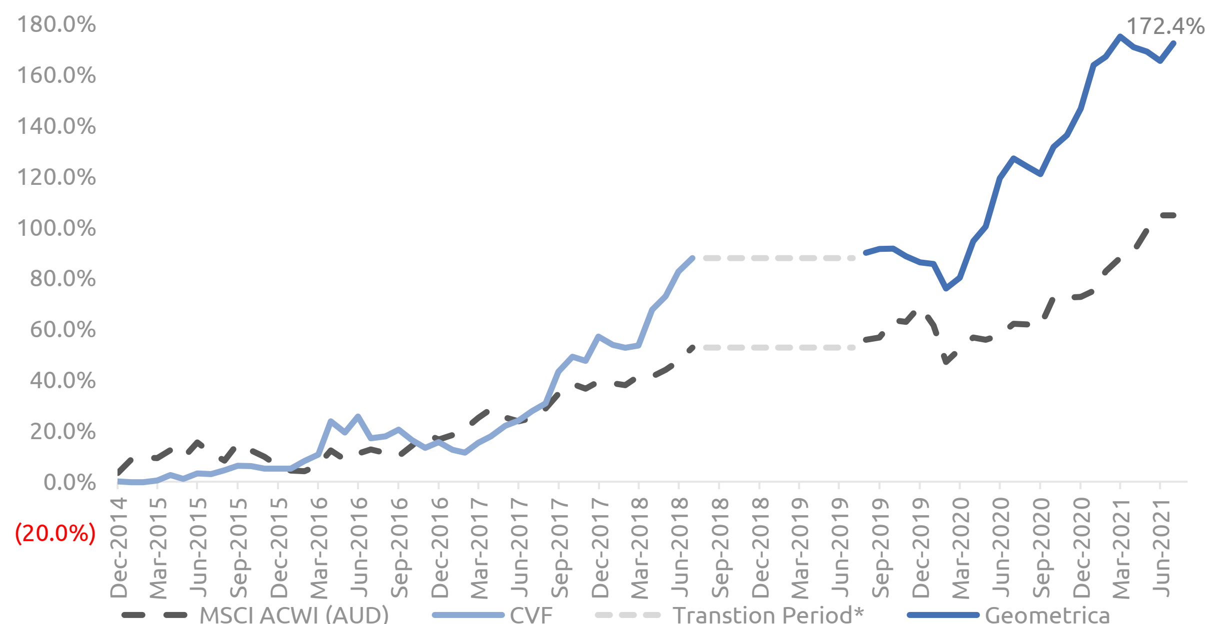
GROSS EXPOSURE



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. Performance is net of all fees.

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