Geometrica Fund

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

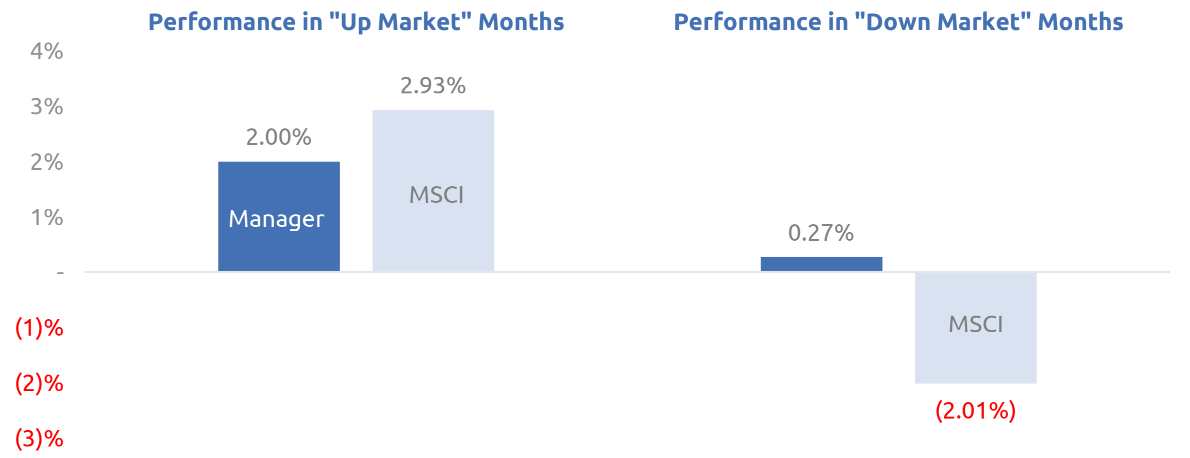
The Geometrica Fund aims to deliver outstanding returns to unitholders via highly targeted investments in the global mid-cap equity universe.

INVESTMENT PERFORMANCE (NET)[1]

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Fund	Index
2019	--	--	--	--	--	--	--	--	+1.1	+0.8	+0.1	-1.6	+0.5	+6.6
2020	-1.3	-0.3	-5.2	+2.4	+7.9	+3.0	+9.5	+3.5	-1.4	-1.4	+4.8	+2.0	+25.2	+5.9
2021	+4.5	+6.9	+1.2	+3.0	-1.5	-0.7	-1.4	+2.6	+3.1	-0.6	-4.6	-0.4	+12.2	+25.8
2022	-4.1	-1.7	+1.5	+0.5									-3.8	-10.9
										Since Inception			+35.6	+26.5

30 Apr 2022	Inception pa	2 year pa	CYTD	1 year	6 months	3 months	1 month
Founder[1]	+12.16%	+18.92%	-3.84%	-7.31%	-8.68%	+0.27%	+0.46%

PERFORMANCE ASYMMETRY



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 +0.5%[1] for the month of April 2022.

[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.*

April was a minor bloodbath in global equity markets with the bellwether S&P500 Index down -8.8%. The tech heavy Nasdaq Composite closed down -13.3% and the MSCI All Countries World Index was down -2.8% in AUD terms.

Index name	Return
Geometrica	0.5%
FTSE 100 INDEX	0.4%
S&P/ASX 200 INDEX	(0.9%)
DAX INDEX	(2.2%)
MSCI ACWI	(2.8%)
NIKKEI 225	(3.5%)
S&P 500 INDEX	(8.8%)
NASDAQ COMPOSITE	(13.3%)

SHORT BOOK CONTRIBUTION

Active management of gross and net exposure and short book contributions have been crucial to our ability to protect capital during a pretty violent sell off across the last few months.

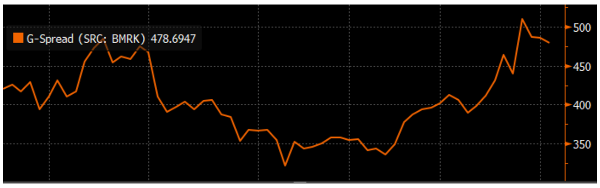
We lost a small amount on our longs in aggregate during April, but the short book's positive contributions more than offset these losses resulting in a positive return overall. A pleasing result cast against a truly vicious sell off in risk assets.

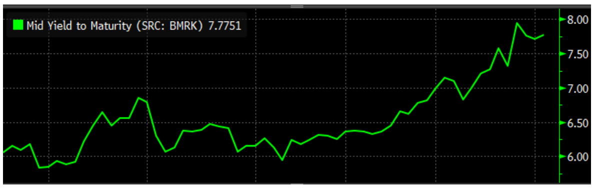
Shorts in "profitless tech" companies were profitable, with many surprising sharply to the downside during the month. In retrospect, we covered many of these shorts too soon which in combination with their share price declines saw the short book shrink by month end. We have since almost doubled our short book in size, increasingly into other areas of the market appearing vulnerable.

To give you a feel for the magnitude of the moves in the once uber-popular complex of profitless tech stocks, we disclosed Carvana as a short in our March letter which has fallen from its peak of $370/share to $38/share at the time of writing.

We covered at ~$60/share after Carvana undertook a large and highly dilutive equity raise, reasoning that with the near-term solvency risk addressed, the stock could rally hard. Instead, the stock tumbled almost 50% lower over the next few days on particularly heavy volume.

Another area benefiting short performance has been market repricing of corporate bonds. Credit spreads, in particular for sub investment grade debt, have been moving wider as sovereign yields are rising. The below charts show this dynamic; rising credit spreads and sovereign yields (not pictured) driving rapidly rising borrowing costs (right chart below for one distressed issuer's 2027 bonds).





By searching for companies where a refinancing of all outstanding debt at current market-based interest rates would result in a rise in debt cash servicing costs large enough to materially compress earnings, we've found a few profitable shorts. This is a theme we think with a long runway ahead because we have seen the high yield bond market all but close in prior cycles leaving corporates with no alterative but to "shoot the shareholder" aka raise equity or sell assets at a bad point in the cycle.

Europe, with its backdrop of negative sovereign yields and thus possibly artificially compressed corporate debt costs seems most vulnerable in this context.

THE IMPORTANCE OF AVOIDING A "ROUND TRIP"

There is no worse feeling as an investor than making a lot of money on a stock…and then promptly losing it all.

I have a vivid (and painful) memory of committing this investing sin almost a decade ago on a large position which doubled…and then fell all the way back down again. Hero to zero.

Picture this as a mental map for the "Covid Round Trip":

Onset of covid

- A company benefits from Covid lock downs; its sales boom.
- This translates into surging margins and earnings.
- The margin and earnings benefits are temporary.
- Despite this, the equity market *increases* the valuation multiple applied to these temporary earnings.

Washout

- Covid benefits subside. Sales fall. Margins fall.
- Stock price fully mean reverts. The round trip.

One possible example

- If there was ever a poster child for Covid beneficiaries it would be **Zoom** Video Communications (ZM.US, mkt cap US$26.6bn). Zoom was so successful during the covid lock downs that its name became synonymous with video conference calls. But perhaps just like Xerox, that's no guarantee of ultimate success.

Zoom: From 31 January 2020 to 30 April 2022

In October 2020 Zoom peaked at $568.34/share. If you were savvy enough to buy it at the end of March 2020 at $117.23 a share, you'd have been up 384% by the time the stock peaked in October 2020.

Now back in October 2020 when the Zoom share price peaked at $568.34/share, the consensus EPS forecast for 2023 was $3.31/share.

By end April 2022, the Zoom share price was much lower at $99.57; down roughly -82.5%. Yet the consensus FY23 EPS forecast is UP +5.8% at $3.50/share.

So, what gives? <u>How can the earnings be UP and the stock price DOWN?</u> As the investment parable runs: "*it's the multiple, stupid.*"

	Oct-20	**Apr-22**	**Change**
FY23 EPS	$3.31	$3.50	5.8 %
Multiple	171.7 x	28.4 x	(83.4)%
Share price	$568.34	$99.57	(82.5)%

	Oct-20	**Apr-22**	**Change**
FY26 EPS	$10.31	$5.44	(47.3)%
Multiple	55.1 x	18.3 x	(66.8)%
Share price	$568.34	$99.57	(82.5)%

The above shows FY23 and FY26 EPS estimates for Zoom.

And in both cases, it's the multiple change that's done most of the damage, noting that future growth expectations for Zoom have also cratered.

Date	Oct-20	Apr-22	
Yr	EPS	EPS	*Change*
FY23	$3.31	$3.50	5.8 %
FY24	$5.75	$4.02	(30.1)%
FY25	$7.78	$4.44	(42.9)%
FY26	$10.31	$5.44	(47.3)%

The table above shows that the further out in time you go, the greater the step down in future consensus earnings expectations for Zoom. We'd posit that future earnings expectations drive share prices.

Zoom is hardly alone in executing a share price round trip. We can reel off a long list of similar stocks. The share price charts tend to all be eerily similar.

This is a dynamic that is frankly still playing out. We are as we write adding shorts where the roll-off of Covid benefits has been delayed until quite recently but has much further to run. These are shorts not just in the tech sector.

If like us, you think that over time stocks follow their earnings (or future earnings expectations more precisely) it seems apparent that Zoom isn't getting off the deck any time soon unless its earnings reaccelerate significantly.

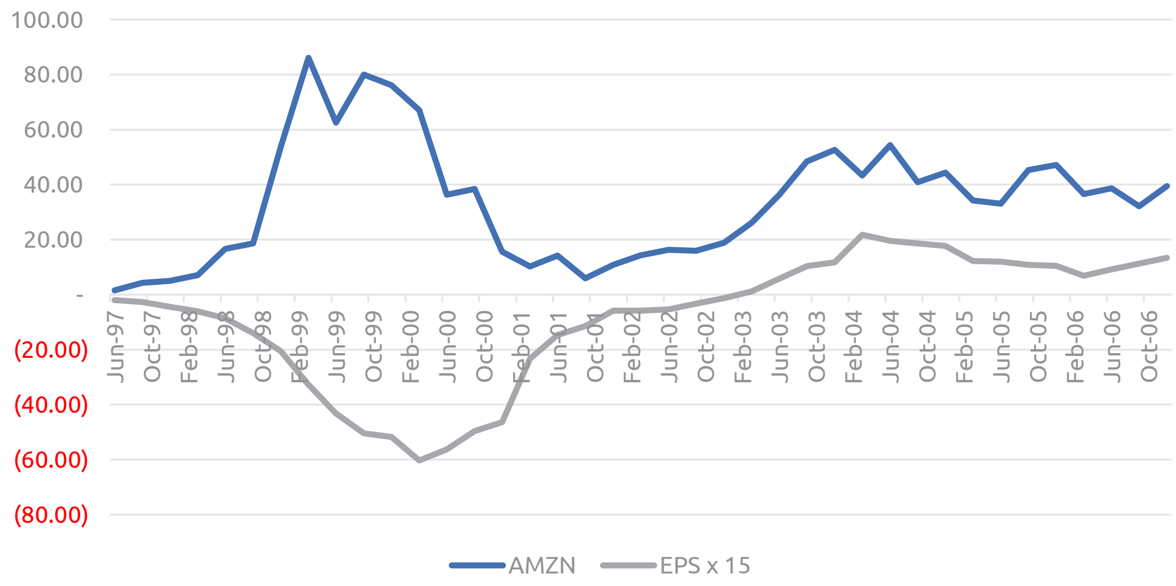
Zoom may be a case where this can happen. Or then again other platforms may offer a similar service for zero incremental cost in order to aggressively target Zoom's user base.

LOOKING AHEAD

It's tempting to turn your back on all these covid beneficiaries that have been poleaxed.

But there are shades of similarity between now and the great dot com bust of 2001. Out of that episode emerged some home run hits; Amazon being the best known example; a stock that traded at under $20/share back in 2001.

The chart below shows Amazon being poleaxed as its earnings fell and then rising rapidly as earnings inflected upwards. The point is we are poring over the wreckage for potential longs. There are gems to be found.



Similarly, out of the US housing and resulting financial crisis came James Hardie at under $4/share. This is a stock we bought below $4/share in a prior fund.

James Hardie case study

- Picture a US housing crash after the peak of housing starts in 2006 and an Australian listed stock whose earnings predominantly derive from its US building materials business.
- You would *assume* its fortunes would be umbilically tethered to US housing starts. Not so. For idiosyncratic reasons, this stock had a unique product that was rapidly taking market share.
- Illustratively only: If you have 5% market share in a 2M start market but grow it to 20% in a 1M start market, you can still double your revenues.

It's a stock picker's market.

The crux question is always "*what's it got*"; what is special about a particular company (and not priced in by the market) that will allow it to extract economic rent far into the future.

We're gradually building positions in a few stocks we think have large upside in the not-too distant-future.

To be clear they may fall in price if the market continues its indiscriminate sell off. But we think we can manage that market-based risk via short selling.

Having protected capital in a vicious down market we want to find things with large upside asymmetry ready to play out over the next year or two. We have a few in the portfolio and want more.

PORTFOLIO

Geometrica was in the AFR last month where we spoke about our short position in **Kogan** (KGN.AU, mkt cap A$393.5mn), you can read the article here: LINK.

We think it's a good example of how our process works, long or short:

- **Search:** We look for situations where there is high degree of uncertainty
  - Kogan had halved in 12 months, but was still up >2x vs pre-covid i.e. reversion to both seemed possible.

- **Evidence:** Evidence and data cut through bias/heuristic-based decision making.
  - Pricing, traffic and COGS data helped guide our assumptions on revenue and margins which were substantially below expectations.

- **Team approach:** The team has a diverse skillset.
  - In this case, the three areas of focus were data, fundamental analysis and market knowledge.

We initially looked at Kogan as a long in August 2021 after it had more than halved and Australia was entering another lockdown (the stock increased ~5x in the last lockdown).

Data and red flags quickly disabused us of this notion, and we shorted the stock. The company went on to miss earnings expectations sequentially in FY21, 1H22 and 3Q22.

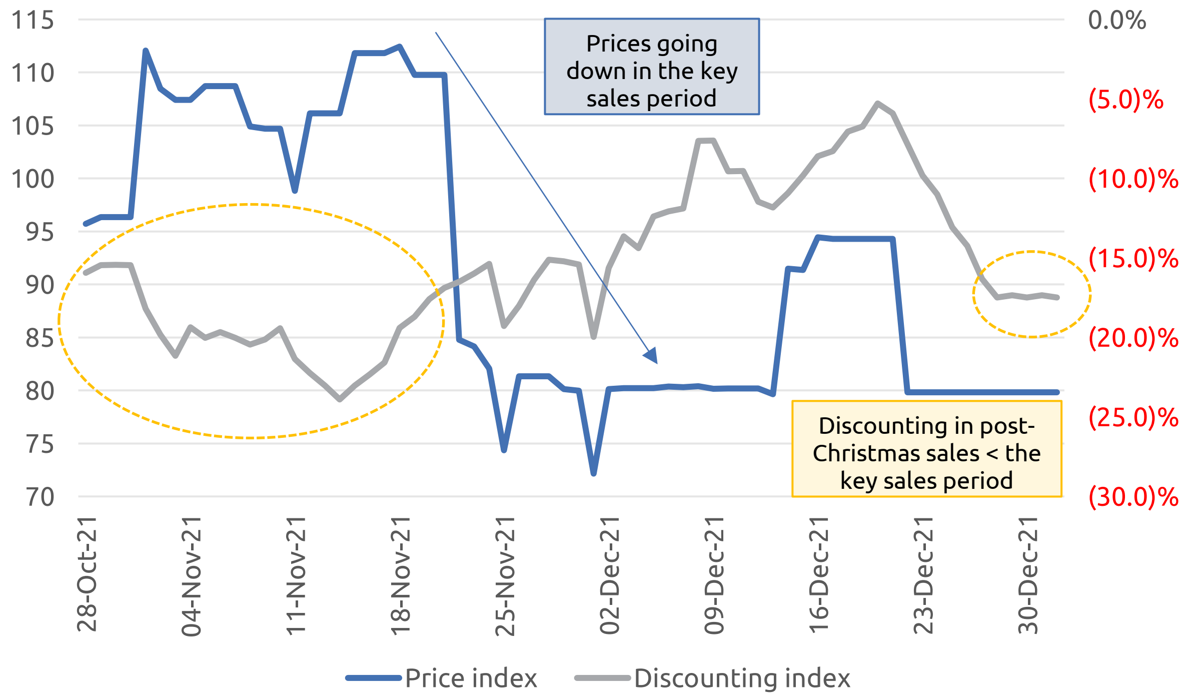
Kogan is an Australian online retailer. 75% of gross profits are generated by segments that take on inventory risk from suppliers. Kogan's eponymously named Exclusive Brands business is the primary driver of profits. The third-party products drive a greater product range and help boost traffic but only contribute ~25% of gross profits.

COVID resulted in a spike in e-commerce demand as shoppers went online. Kogan's EBITDA margin expanded to an all-time-high 2x greater than their historical average and 3x greater than its peers. The market extrapolated these earnings and boosted the multiple.

We assed that Kogan had ~50% downside on a multiple and margin revision scenario. The risk to this thesis was increased demand from ongoing lockdowns. We turned to data to cut through bias and actively monitor risk.

We could track price, discounting, and inventory levels down to the individual product level and we could also see promotions and changes to shipping terms.

November and December are key sales months for Kogan and our data showed increased levels of discounting and promotional activity.



Source: Geometrica analysis

Unique traffic data indicated volumes were also declining.

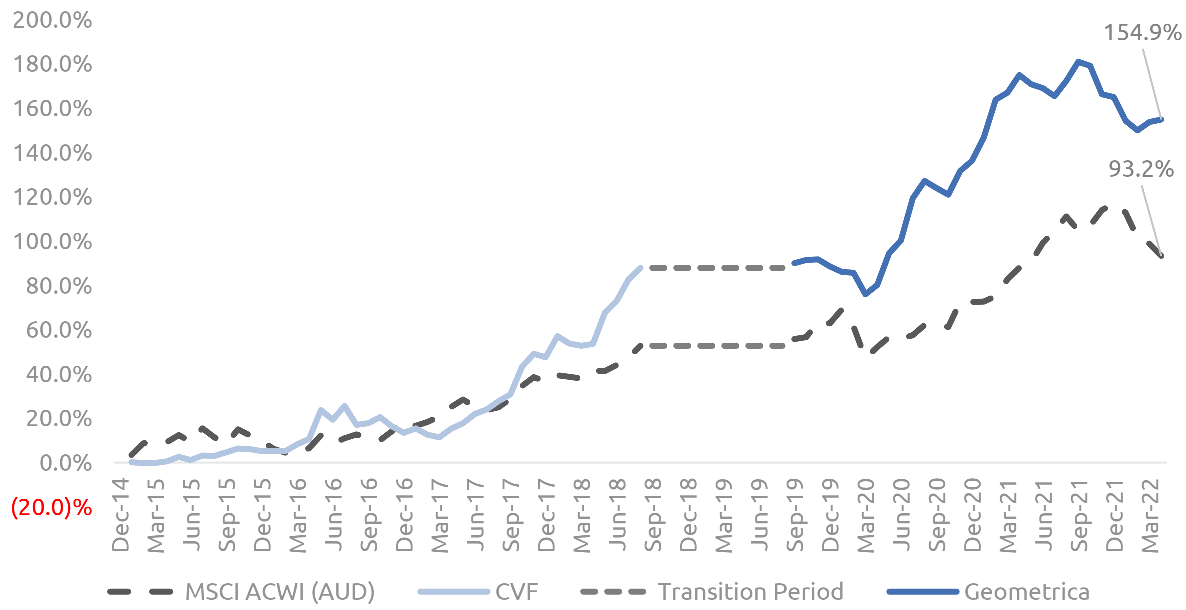
Just as demand was weakening, key cost inputs such as shipping, customer acquisition costs and wages were increasing, putting additional pressure on margins.

Then from 19th August 2020 until 2nd September 2021, key management personnel started selling stock amounting to A$169.1m in total.

Then the aforementioned earnings misses rolled in.

All told, the stock fell ~70% from our initial entry. We retain a small position in Kogan.

MANAGER PERFORMANCE HISTORY

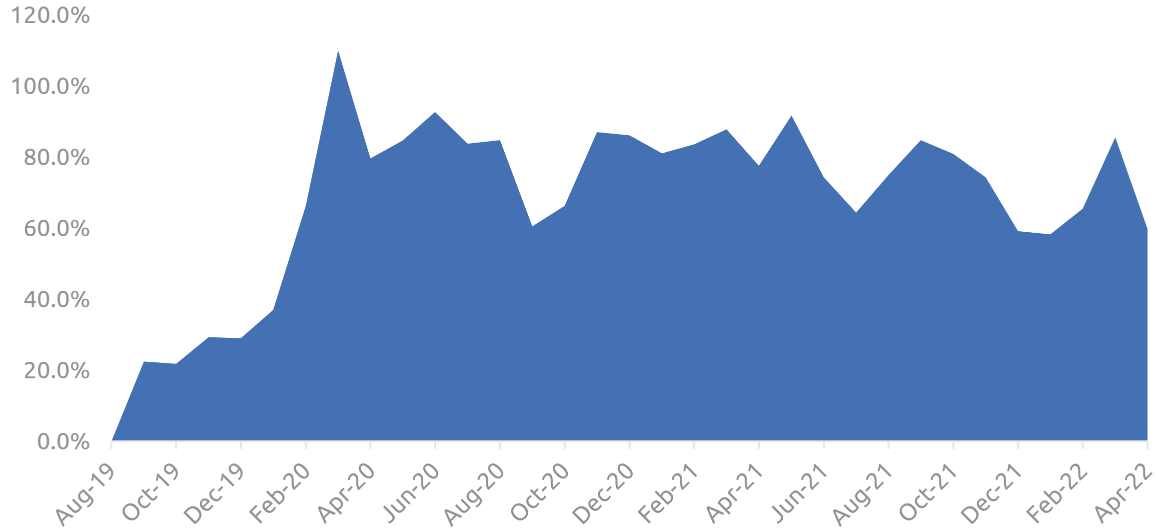


* Manager left CVF in Sept 2018 and began Geometrica in Sept 2019 NB: Performance period is from 5 Jan 2015. Performance is net of all fees.

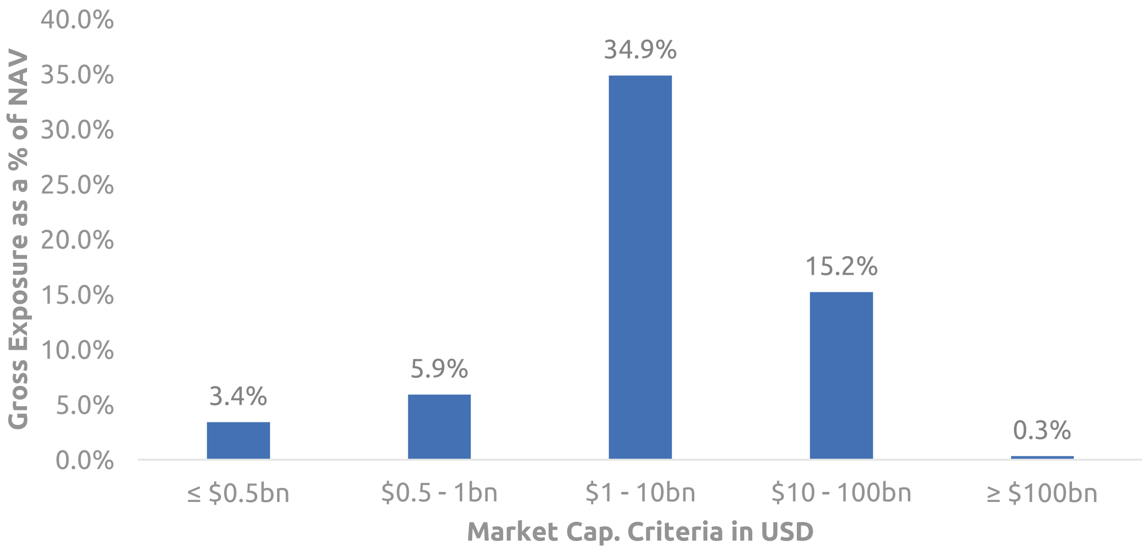
ASSET ALLOCATION

Country	Long	Short	Gross	Net
Australia	25.4%	(2.8)%	28.2%	22.5%
Americas	11.2%	(5.6)%	16.8%	5.6%
Asia	0.3%	(1.4)%	1.7%	(1.1)%
Europe	11.4%	(1.8)%	13.1%	9.6%
Total	48.2%	(11.6)%	59.8%	36.6%

GROSS EXPOSURE



GROSS EXPOSURE BY MARKET CAPITALISATION



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, Netwealth
Fees	1% management (+GST) 20% performance (+GST)
Benchmark	RBA Cash Rate
High water mark	Yes
Liquidity	Monthly
Administration & custody	Mainstream Fund Services