



Watershed Microcap Portfolio

Investment Profile

A Professionally Managed Portfolio of Australian Shares

The Watershed MicroCap Portfolio is a separately managed account, or SMA, actively managed by Watershed Funds Management. SMAs are professionally managed portfolios of direct shares whereby the investor receives beneficial ownership of the underlying securities.

Investment Objective

The objective of the Watershed MicroCap Portfolio is to provide investors with long-term capital growth and limited tax effective income from a concentrated portfolio of stocks with a market capitalisation of less than \$300 million. The Portfolio aims to outperform the S&P/ASX Emerging Companies Index over the medium to longer term (three to five years) by 2-3% per annum, by undertaking rigorous bottom up stock analysis and active portfolio management.

Key Portfolio Features

Inception	30 Oct 2017
Benchmark	S&P/ASX Emerging Companies Index
Authorised Investments	ASX listed companies under \$300m market cap
Number of Stocks	Typically 15-25
Cash Allocation	Default asset, no strategic allocation per say
Investment Horizon	At least 3 – 5 years

The Portfolio is designed for investors who...

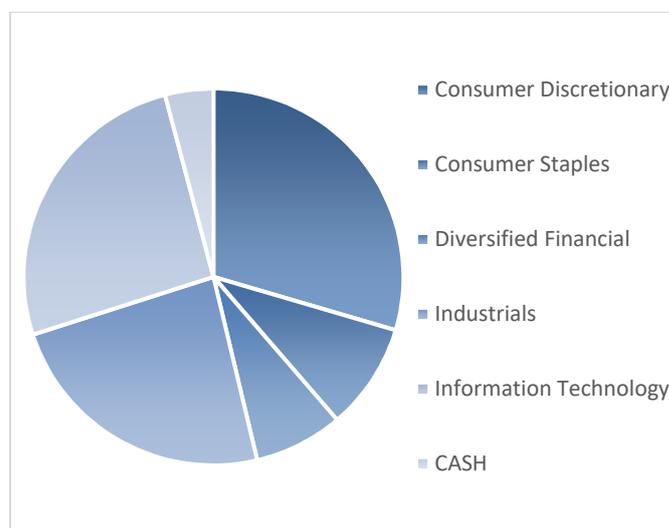
- Seek long term capital growth with limited tax-effective income
- Have a longer -term investment horizon of at least three years and accept the risk of significant price fluctuations.

Portfolio Structure

No.	Company Name	ASX Code
1	Alliance Aviation	AQZ
2	Paradigm Biopharmaceuticals	PAR
3	Reject Shop	TRS
4	Baby Bunting	BBN
5	Data#3 Ltd	DTL

GICS Sector

Consumer Discretionary	24.61%
Consumer Staples	6.55%
Diversified Financial	5.78%
Industrials	19.35%
Health Care	8.10%
Information Technology	19.48%
CASH	4.13%
TOTAL	100%



Performance

Gross Performance (%)	1m	3m	6m	1yr	2yr	Inception*
WFM Microcap SMA	-3.01%	36.81%	8.90%	24.86%	14.00%	13.82%
S&P/ASX Emerging Companies Index	1.37%	44.88%	-10.76%	-1.91%	-2.39%	2.88%
Relative Performance	-4.38%	-8.07%	19.66%	26.76%	16.39%	10.95%

*Inception - October 2017

Performance Fee Disclosure All figures & tables stating investment performance returns (BEFORE administration fees and taxes) for the Portfolio. The performance returns have been calculated on a daily basis taking into account brokerage costs and are accumulated for the period shown. Returns are shown as annualised if the period is over 1 year, or as total returns otherwise.



Quarter in Review

Performance Summary

- The Watershed Microcap SMA has had an exceptional turnaround from the depths of the pandemic-induced sell off. Huge swings in smaller stocks has seen the Emerging Companies Index experience 40% swings, and while the Microcap portfolio significantly outperformed on the way down (as evidenced by the 18% outperformance in the March quarter), it did underperform the June quarter, even after delivering a 36.81% absolute return.
- However strong long-term absolute performance has been cemented after outperforming 19.66% in the last six months, in a calendar year of two distinct quarters. The portfolio closed 26.76% up on the Emerging Companies index in the 2019/20 financial year.

Portfolio Adjustments

During the quarter the following changes were made:

Bought: PAR, UWL

Sold: DXN

Trimmed: DTL, JLG, LOV, TRS

Quarterly Performance Attribution

Top Contributors	Key Detractors
TRS	AHF
PAR	DXN
AQZ	

While the March quarter sell-off was nothing short of startling in terms of speed and magnitude, the June quarter was just as unprecedented, only it was in the other direction.

As we mentioned last quarter, the Investment Committee had fortuitously carried elevated cash levels into 2020 believing valuations were getting expensive. Having clearly not predicted a global pandemic, the opportunity

During the panic the portfolio was able to pick up several quality stocks that came into our investable universe. BBN, LOV, AMX, CLV have all had material bounces since their addition.

The portfolio took some profits during the quarter in stocks that were net beneficiaries of the shutdown, being DTL, JLG, LOV and TRS. With Lovisa having only been added in March, it shows the strong rebound the market has experienced. The two new additions to the portfolio during the quarter were Paradigm (PAR) and Uniti Wireless (UWL).

Paradigm Biopharmaceuticals (PAR) is an Australian biotechnology company focused on repurposing Pentosan Polysulfate Sodium (PPS) for the treatment of Osteoarthritis in the knee. While the drug has been approved in an oral format for many years, the repurposed drug will require further approval for the proposed formal and dosage which are new. Having completed Phase II study, the encouraging results have warranted clinical trials which are currently underway. Given the previous format history we view provisional approval being granted earlier than expected.

In the US along the incidence of moderate to severe osteoarthritis is estimated at 30M persons. The pricing of the drug will ultimately be determined by the economic benefit associated with its use as well as the cost of other therapies. The conservative estimate is US\$2,500 per year which places the addressable market in the tens of billions of US\$.

The second addition to the portfolio was Uniti Wireless. UWL specialises in fixed wireless, fibre and telco services. Its supplies this infrastructure to high density dwellings (i.e. apartment buildings), upon which resellers provide services to the household. Uniti generates long term annuity style revenue from these fibre assets. The shift to work from home has also helped UWL as the needs for faster speeds are needed to work efficiently, playing right into Uniti's wheelhouse. After a strong 2019, UWL retraced to a highly attractive entry point sitting ~30% below historical levels on a free cash flow multiple in FY21. (13x now vs 20x historically).

As portfolio managers our role is to remain dispassionate during the wave of hysteria that can accompany rapidly falling markets and doomsday headlines that inevitably accompany a pandemic. Though painful and frightening, the path beyond a stock market crash tends to be a very profitable journey for people that can remain calm and objective, as has been the case. Pleasingly, the adjustments we made to the portfolio in the previous two quarters have already reaped significant rewards with the