



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...

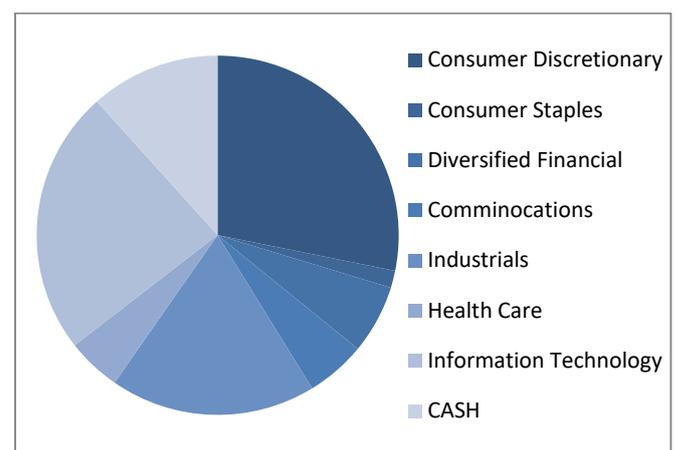
- Seek long term capital growth with limited tax-effective income
- Have a longer -term investment horizon of at least three years and accept the risk of significant price fluctuations.

Portfolio Structure

No.	Company Name	ASX Code
1	Alliance Aviation	AQZ
2	Objective Corp	OCL
3	Baby Bunting	BBN
4	Lovisa Holdings	LOV
5	Praemium Ltd	PPS

GICS Sector

Consumer Discretionary	28.17%
Consumer Staples	1.54%
Diversified Financial	6.19%
Comminocations	5.37%
Industrials	18.39%
Health Care	4.86%
Information Technology	23.84%
CASH	11.64%
TOTAL	100%



Performance

Gross Performance (%)	1m	3m	6m	1yr	2yr	3yr	Inception*
WFM Microcap SMA	-0.98%	2.23%	8.81%	76.43%	30.61%	19.43%	19.18%
S&P/ASX Emerging Companies Index	-2.60%	3.24%	21.21%	113.04%	23.69%	11.92%	14.44%
Relative Performance	1.62%	-1.01%	-12.41%	-36.61%	6.92%	7.51%	4.73%

*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 delivered a return of 2.23% in the first quarter of 2021, slightly underperforming its respective benchmark by which returned 3.24%.
- The portfolio is now 12 months on from the depths of the market lows in March 2020. On an absolute basis the portfolio has returned a phenomenal 76.43%. However this underperformed the benchmark by 36.61%. While the portfolio significantly outperformed on the way down, the portfolio has underperformed in the subsequent market rally on a relative basis. Yet longer term the portfolio remains well above the Emerging Companies Index

Portfolio Adjustments

During the quarter the following changes were made

Additions: WBT

Removals: CLV

Quarterly Performance Attribution

Top Contributors	Key Detractors
LOV	AMX
BBN	CBR
UWL	TRS

Market Summary

The small end of the market has held up strongly, especially given the re-rate of high multiple stocks given the growth to value trade seen in the broader market. A spike in inflation expectations led to a surge in bond yields that saw a retracement in high multiple stocks that were beneficiaries of the Covid lockdowns. While this appears to have washed through, the risk is not gone and there is a risk of inflation surprising on the upside given the huge amounts of global stimulus pumped into economies. While micro caps are more focussed on their own growth stories, they are not immune to a multiple re-rate from higher discount rates which is something we are watching closely.

Portfolio Positioning

Citadel Group (CGL) was taken over in December with a \$449m takeover from Pacific Equity Partners (PEP). The software and services company specialised in managing information in complex environments and has key customers in government and healthcare services. The scheme of arrangement for \$5.70 per share represented a significant 43.2% premium to the last closing price of \$3.98. The funds from the takeover now sit in cash waiting for an opportunity to deploy.

During the March quarter there were two key changes to the portfolio. Clover Corp (CLV), a key manufacturer of Omega 3 oils/powder for baby formula, was divested as trailwinds for the sector don't seem to be abating with geopolitical tension with China as well as Covid impacts to the diago channel impacting demand for imported baby formula. The company was well placed to benefit from the proposed regulatory change in China to increase the minimum dose to 15mg of DHA in infant formula, however exogenous factors have outweighed this development.

The position was replaced by exciting memory chip developer Weebit Nano (WBT). Weebit is an Israeli tech company that has developed a non volatile ReRam (Resistive RAM) technology based on popular chip material, and fab-friendly, silicon oxide. The technology is a breakthrough in technology that is 1,000x faster and 1,000x more energy efficient than existing flash memory technology. The product has been proved as stable and is now in the process of finding a fabricating partner. The non volatile market is estimated to be worth US\$60bn and expected to grow at double digit growth. The company has put in a very experienced management team and board with unrivalled industry knowledge and connections. The company has a number of patents in place to protect its IP. We think the opportunity here is extensive and have introduced a small position in the portfolio with the view to add in any weakness. As can be the case with companies pre revenue, news flow can dictate the share price, hence only the small weight to begin with. The company is hoping to have its first commercial agreement by mid 2021.

The portfolio ends the quarter with just over 11% cash, a position we are comfortable with given the market rally. This also gives us fire power to deploy on short notice if any compelling opportunities present themselves.