ASX: SEC

Investment Update

As at 31st August 2021

Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets[4]

$2.749

Company[7] performance p.a. (since inception)

12.6%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	$2.49
Inception date	30 November 2017
Listing date	5 December 2017
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Management Fee	1.00% (plus GST) per annum[1]
Performance Fee	20% (plus GST) of the Portfolio's outperformance[2]
Market Capitalisation	$149.8m

[1] calculated daily and paid at the end of each month in arrears
[2] against the Benchmark over each 6-month period subject to a high-water mark mechanism

Commentary

The Company performance for the month of August was 6.0%, while the S&P/ASX Small Ordinaries Accumulation Index returned 5.0%.

Markets

Markets locally rose strongly over August adding yet further to the stunning recovery in the small/mid-market since the lows seen in late February 2020. Performance was relatively broad based but biased to sectors enjoying strong sentiment with significant gains seen in battery materials names, biotechs and fintechs but also solid performance in REITS, many COVID-19 re-opening plays and several under-owned names that had high short interest. Gold exposures significantly underperformed as the equities followed the gold price down after a "flash crash" early in the month on fears of U.S. Federal Reserve QE tapering but failed to rise as the gold price recovered the entirety of the loss later in the month. Iron ore exposures were also significant underperformers during the month as the benchmark for iron ore fell a further 20% during the month after rolling over from record highs in July.

Retail exposures that had traded well through COVID-19 on share of wallet gains as services spending was diverted to goods spending, were amongst the laggards as the market turned its names to those who might benefit from re-opening. Companies reporting disappointing results or outlook not directly relating to COVID-19 were unsurprisingly punished with Electro Optical Systems (EOS.ASX), Starpharma (SPL.ASX), AMA Group (AMA.ASX), Synlait (SM1.ASX), Bravura Solutions Ltd (BVS.ASX), Paradigm Bio (PAR.ASX), Mesoblast (MSB.ASX) and Altium (ALU.ASX) all down more than 10% for the month.

The portfolio outperformed due to an overweight to re-opening names, an underweight to gold and long positions in several stocks that saw earnings upgrades (e.g., GR Engineering) and in some cases shorts capitulating (Blackmores and Invocare).

While the portfolio has performed well on a relative and absolute basis and we continue to find opportunities for rotation that tick our boxes on cashflow, balance sheet strength and valuation we remain concerned about speculative excess in certain areas of the market. High momentum names exposed to popular thematics in the battery materials, fintech and biotech names in particular appear to have become completely detached from any semblance of intrinsic value. We will continue to avoid these names and instead focus our attention on the quiet achievers that generate

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solid cashflows at decent valuations and are being ignored by the crowd. We believe the market remains conducive to elevated levels of M&A activity that have historically buoyed our returns given our preference for undervalued, cash generative businesses with underleveraged balance sheets sees our portfolio companies being the target of this activity more commonly than the average index constituent.

Major Contributors for the Month

Blackmores (BKL.ASX) was the largest contributor as the stock soared 37% on the back of a much-improved result from last year's depressed base and the confident issuance of outer year (FY24) revenue and margin targets. While Blackmores looks expensive optically on near term earnings, we like the new management's strategic initiatives to take costs out of the business and simultaneously grow topline sales and see good prospects for such growth in South-East Asia and pet care products in particular.

GR Engineering (GNG.ASX) was the next largest contributor as the specialist Engineering, Procurement and Construction contractor of mineral processing plants delivered a result above expectations and provided outlook commentary that saw solid upgrades to consensus. With a solidly net cash balance sheet and a mid-single digit EBIT multiple we still see upside in the name given strong tailwinds in its clients' commodity exposures and its excellent record of delivering processing plants on time and on budget.

Class (CL1.ASX) contributed after delivering a marginally better than expected result that saw it return 16% after it had badly lagged the market since delivering an inline 1H21 result. We still see the specialist provider of cloud-based accounting, investment reporting, document and corporate compliance software as well placed to deliver double digit earnings growth and continue to believe it screens well compared to other software exposures.

Major Detractors for the Month

Pilbara Minerals (PLS.ASX - Not owned) was the largest detractor as the stock rose another 26% over the month as the benchmark lithium carbonate price in China rallied 32% over the same period. The stock had already run hard previously however with the cumulative stock return over 80% since end May while the lithium price is up 38% cumulatively. Trading at more than 10x NTA for a producer that has shown itself to be well outside the bottom quartile of cost producers (retained earnings are negative $254m post the last commodity cycle) we feel the stock has gotten well ahead of the fundamentals, particularly in light of an obvious and very large industry supply response. Interestingly we note that fellow lithium producer Mineral Resources (MIN.ASX) sold its entire 5.4% holding in PLS.ASX in early September.

Adbri (ABC.ASX) detracted upon returning a modest -3% in a market that was strongly up for the month. The producer of cement, lime, concrete and aggregates reported a solid result but flagged somewhat weaker than expected near term conditions driven by COVID-19 induced delays in East Coast construction and a slower than expected uptick in infrastructure demand. We remain constructive (pardon the pun) on the name as we continue to believe the market is not giving it credit for the likelihood that it replaces lost lime revenue and earnings with new Western Australian mining project clients.

Vita Group (VTG.ASX) detracted from performance as it returned –10% over the month after reporting a tough 2H21 result driven by COVID-19 social distancing restrictions. Vita has succeeded

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historically due to exceptionally strong sales skills making its consultants better able to drive profitability from stores than other Telstra store franchisees. The social distancing restrictions in place and lower mall traffic is impacting on Vita's ability to upsell customers into better margin products and services. The market may also have been disappointed that the group was not able to finalise the sale of its franchised business back to Telstra by result date in-line with Telstra's stated intention. We continue to see Vita as undervalued given its ownership of an emerging skin health clinic business (Artisan) with $30m of annualised sales, $31m in net cash, $75m in franking credits and a Telstra franchised business that we believe is worth well more than the implied valuation derived from the current market capitalisation.

Outlook & Strategy

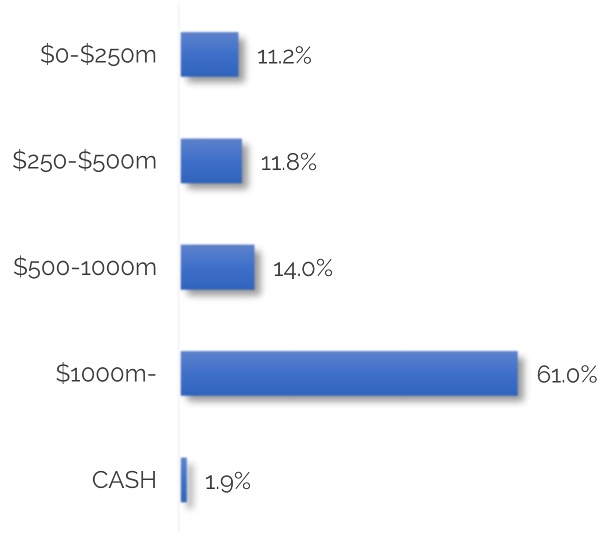
While we never seriously doubted that humanity would find a way through the challenges of COVID-19 we are even more firmly of the view that the Australian economy will see out the delta outbreaks in New South Wales and Victoria with vaccination rates rising rapidly and the international experience suggesting that the current crop of vaccines are sufficient to keep morbidity at acceptable levels (even if booster doses like those being rolled out in Israel are eventually required). Our philosophy of buying cash generative business models, with solid balance sheets and returns and sensible valuations remains unchanged despite the challenges of managing money against a benchmark increasingly driven by retail, quantitative and index investors. We feel conditions remain conducive to high levels of corporate activity given plentiful liquidity, procyclical boards and record levels of private equity dry powder. We believe this will continue to present a tailwind for our returns given our predilection for undervalued, cash generative businesses with modestly or underleveraged balance sheets. We will continue to avoid names trading well above their intrinsic value and stick with our disciplined investment approach that is driven by valuation fundamentals.

Top 10 Holdings

Company Name	% Portfolio
Blackmores Limited	4.3
Flight Centre Travel	4.3
Adbri Limited	4.0
City Chic Collective	3.9
Fletcher Building	3.8
Ioof Holdings Ltd	3.5
Seven West Media Ltd	3.4
Bega Cheese Ltd	3.3
Monadelphous Group	3.2
Healius	3.2
Top 10	**37.0**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)[3]

Pre-tax NTA[4]	$2.749
Post-tax NTA[5]	$2.605

[3] NTA calculations exclude Deferred Tax Assets relating to capitalised issue cost related balances and income tax losses

[4] Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses

[5] Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings

Performance as at 31st August 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.[6]
Company[7]	6.0%	17.7%	48.1%	12.5%	12.6%
Benchmark[8]	5.0%	15.6%	29.5%	10.1%	10.6%

Past performance is not a reliable indicator of future performance.

[6]Inception date is 30th November 2017

[7]Calculated as the Company's investment portfolio performance after fees excluding tax on realised and unrealised gains/losses and other earnings, and after company expenses

[8]Benchmark is the S&P/ASX Small Ordinaries Accumulation Index. All p.a. returns are annualised

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