ASX: SEC

Investment Update

As at 28th February 2019

Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets[4]

$2.043

Company[7] performance (since inception)

4.2%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	$1.715
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	$114m

[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's pre-tax NTA increased by 6.1% during February. This represented underperformance of 0.7% compared to the benchmark S&P/ASX Small Ordinaries Accumulation Index which increased by 6.8%.

The market correction that occurred in the December quarter was mostly recouped in January and February with the S&P ASX Small Ordinaries Accumulation index bouncing over 16% from its low point. The sharp lift in February was due to a better than expected profit reporting season - expectations were extremely depressed. Ridiculously, stocks that were very highly rated going into results that delivered in-line or better (assessed against some metric that was rarely the actual profit) were re-rated even more aggressively. We suspect this reflects the growth in quantitative based strategies that are tuned to earnings momentum without a valuation overlay, and in general a market that is fixated with earnings upgrades and downgrades with little to no regard for absolute valuation. These share price movements were exaggerated by short covering, we suspect many hedge funds were shorting on heightened macro-economic fears in December and into reporting season.

Despite swimming against the "momentum" tide we generated a reasonably solid performance for the month across our key strategies. Positively, the companies we own are for the most part performing well (i.e. from a business perspective) based on the reported results and are trading at relatively low multiples, which affords us protection if the bubble does burst at the more highly rated end.

The top three share price performers (including dividends) for the month of February were:

Breville (BRG, +45%)
BRG designs and develops electrical kitchen appliances which it sells globally - more than half its revenue is derived from North America. We initiated the position in BRG last year at an average price of approximately $11. The result continued the strong momentum witnessed over the last three years with revenue growing 15% and EBIT 13% for the half year. There was a furious rally post the result and the stock is now trading at near 20x EBIT, which is relatively expensive. However, the outlook for the group remains strong, particularly the European division which has yet to see the full benefit from the direct distribution strategy.

Vita Group (VTG, +33%)
VTG operates 100+ stores for Telstra. It delivered a strong result with revenue growing 14% and EBIT 27%. VTG has engineered a return to growth under a tougher remuneration model implemented by Telstra a couple of years ago. The key being the cross-sell of its home brand accessory product (Sprout) that is now about $50m of sales. Two years ago, this was less than $30m. The gross margins for Sprout are very high, such that we believe it represents a large proportion of VTG's earnings, which means VTG is less exposed to any prospective remuneration changes. Despite a strong share price recovery, the company remains extremely cheap (5x EBIT). There is a headwind in FY20 with the loss of $11m of high margin revenue from

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Commentary (continued)

Telstra, however, we think the arrival of 5G and the growth in Sprout will more than compensate.

GBST (GBT, +30%)
GBT is specialist financial technology company which provides administration processing software for life insurers and wealth management organisations. It also has capital markets software that caters for stockbrokers. GBT delivered a weak half year result as expected with negligible free cash flow due to significant development spend on their wealth management product. The investment should drive growth via future client wins, the outlook for the 2H of 13-14% revenue growth potential validation of the strategy. The company is relatively cheap if it starts to deliver top line growth and contains costs as 2H guidance suggests.

The bottom three share price performers (including dividends) were:

Blackmores (BKL, -28%)
Blackmores is a natural health company that develops supplements for humans and animals. The half year result was disappointing given strong sales growth of 13%, somehow translated to negative underlying EBIT growth. We struggle to understand how a company can double its sales in the past 4 years and see EBIT margins fall from 15% to 12%. There is nothing wrong with the market, it is simply an execution issue at BKL. We believe the recent resignation of the CEO is positive. The business clearly needs new leadership/management, and a plan to achieve margins consistent with its peers. We understand Swisse its main competitor generates EBIT margins > 30%. There is clearly upside to BKL if costs are re-aligned with revenue.

Mortgage Choice (MOC, -11%)
MOC is a financial services organisation with its core operation being mortgage broking. It has suffered a string of negative events with the final nail in the coffin being the Hayne Royal Commission recommendation to eliminate mortgage broking commissions. Any rational observer would have been flabbergasted by this outcome given the role brokers play in extracting a better price for the consumer. To make the industry unviable beggars belief given the Big 4 would simply dominate the mortgage market and gouge customers as they did prior to the advent of brokers. Consumers have voted with their feet with 60% of market volumes currently written via a broker. The reason for that is first and foremost they get you a much better interest rate (we can attest to that). The only people recommending against brokers are the Big 4 banks and those people that have never negotiated a mortgage or haven't since 1974. With the government backflipping on the trail commission ban and the Labor party proposing an upfront fee (1.1% or less) paid by the bank, we feel the situation has moved from a worst-case scenario to business as usual. Trading on <7x EBIT with a net cash balance sheet, risks are now heavily skewed to the upside for MOC. Despite negative sentiment toward housing, we suspect industry growth will return particularly given the banks will lend again with the Royal Commission now a wasted chapter in history.

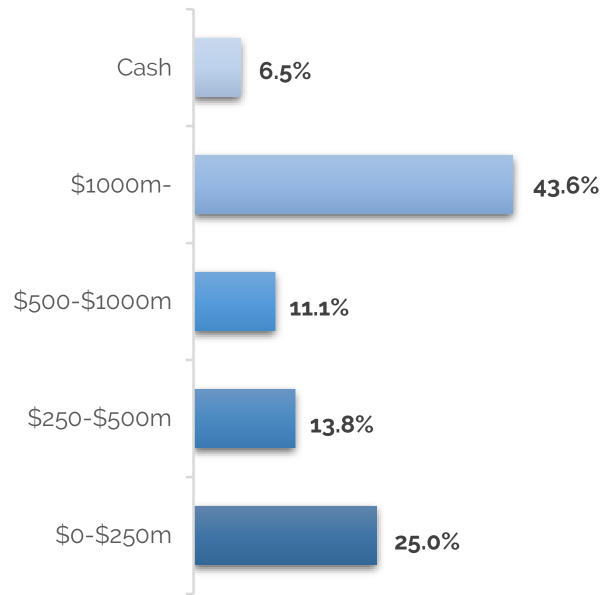
Bega Cheese (BGA, -6%)
BGA is engaged in the processing, manufacturing and distribution of dairy and associated products (including Vegemite) to both Australian and international markets. Like MOC, it has faced a series of negative influences with the primary issue being the impact of the drought on milk supply. This will continue to impact the company during 2019, which means further downward pressure on earnings. The company reported a very weak first half result, like many of its agricultural peers. Cash flow was negative due to ramp of milk supply at Koroit, higher farm gate milk prices due to competition for lower supply, and contractual terms which precluded BGA from engaging with Koroit customers until after settlement. The result being a very stretched balance sheet at 31 December 2018, beyond the usual seasonal peak debt levels. We believe there will be a significant unwind of inventory in the June half year. The inventory is clean and the company will factor some of its sales to bring forward cash flow from powdered milk sales that occur in May/June that are normally received in July/August. Given Fonterra's current financial predicament and Saputo having spent $1.5bn on acquisitions, we think domestic pricing should improve allowing participants to generate an adequate return on capital. Global pricing is also improving due to global milk supply issues. On the spread front, we believe Kraft which debased pricing for Bega's Peanut Butter offering may desist given its market share at <10% would likely be unprofitable. Kraft/Heinz doesn't seem to be in position to fund loss making lines given the accounting scandal and major profit downgrade which has seen share price collapse. On a positive note, BGA lifted pricing on Vegemite last year, we believe this lever can be pulled more regularly going forward given the monopolistic nature of the product.

Top 5 Holdings

Company Name	% Portfolio
Navitas Limited	6.3
Platinum Asset	5.2
Fletcher Building	5.0
Bega Cheese Ltd	5.0
Monadelphous Group	4.6
Top 5	**26.1**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)[3]

Pre-tax NTA[4]	$2.043
Post-tax NTA[5]	$2.082

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

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

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

Performance as at 28th February 2019

	1m	3m	6m	1 yr	Inception[6]
Company[7]	6.1%	5.4%	-2.7%	0.0%	4.2%
Benchmark[8]	6.8%	8.0%	-3.1%	3.5%	4.8%

Past performance is not a reliable indicator of future performance.

[6] Inception date is 30th November 2017

[7] Calculated as movement in Company's pre-tax NTA (which includes tax on realised gains and other earnings, but excludes any provision for tax on unrealised gains), assuming the re-investment of any dividends paid by the company

[8] Benchmark is the S&P/ASX Small Ordinaries Accumulation Index

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