

Investment Update

As at 31st January 2021



Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets⁴
\$2.298

Company⁷ performance
p.a.(since inception)
8.0%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	\$1.93
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	\$117m

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 January was -0.5%, while the S&P/ASX Small Ordinaries Accumulation Index returned -0.3%.

Markets

Markets locally were broadly flat in January after a solid increase over the latter half of 2020 including December. January was characterised by some generally positive trading updates from a raft of retailers who continue to see their businesses spurred on by an accommodative economic backdrop and continued crimping of spending in other consumer discretionary areas (namely Tourism and Leisure). The macro environment – despite the uncertainties caused by Covid 19 – is highly supportive of both company earnings (in most sectors) and asset prices. This is likely to continue to lead to upward pressure on stock prices. It is also likely to drive M&A and other corporate activity as we have noted for a while. January did not disappoint here either with a consortium of CPE Capital (formerly Champ Private Equity) and Macquarie Infrastructure and Real Assets (MIRA) emerging for Bingo Industries (BIN.ASX).

Precisely how long we will be in this macro environment is anyone's guess, but the answer appears to boil down to how long Central Bankers can keep playing a double bluff with monetary policy. Whilst there is a lack of the spectre of inflation, effectively printing money remains the key modus operandi of both Central Banks and Governments worldwide. For Governments this means taking on additional debt comes with little to no (and in some cases negative) cost. Until investors in fixed income come to believe they need higher rates to compensate for long term bond risk, it seems the macro environment is likely to remain extremely accommodative. The alternative is that perhaps the correcting mechanism this time will be social/political as opposed to fiscal or monetary policy. Whilst there has been little consumer price inflation (in the limited way CPI is measured) there certainly has been asset price inflation. This creates additional social divide in a society and could ultimately be the driver of monetary or fiscal reform for example by way of additional taxes.

Major Contributors for the Month

Ainsworth Gaming (AGI.ASX) rose 67% over the month (after returning 52% in December). AGI had not participated at all in more buoyant sentiment towards COVID-19 recovery trades, hitting

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all-time lows in November 2020. Market participants finally began to appreciate that the business has a valuable portfolio of State gaming machine licences in the US and that its solvency is underwritten by land and buildings worth materially more than the historical book value disclosed in the accounts.

Polynovo (PNV.ASX – not held) contributed meaningfully versus the index as it declined 32% over January. PNV provided a sluggish sales update for Q2 2021, with revenue growth showing a substantial slowdown sequentially on their first quarter revenue growth of 75%. PNV remains a very highly rated company and is not cashflow positive making this the type of investment our portfolios typically don't hold.

Breville Group (BRG.ASX) rose 13% over January. There has been limited news flow behind the move other than continued strength in retail numbers across the board but in particular in anything homewares related. Channel checks with US retailers continue to indicate BRG's trading has remained robust with the perceived quality of the Breville brand able to support premium pricing.

Major Detractors for the Month

Adbri (ABC.ASX) declined 14% over the month on the back of limited news flow. The backdrop of continued recovery in building approvals and increases in infrastructure spending should continue to be supportive of economic environment for Adbri.

ZIP Co (Z1P.ASX – not owned) rose 37% over the month on the back of a trading update that revealed very strong US topline growth. ZIP is one of many BNPL competitors yet to go through the inflection point of profitability with accounting profits and cashflows still meaningfully negative. While we appreciate the market opportunity in the U.S. is large, we do not see how ZIP's Quadpay will outcompete the likes of Paypal, Afterpay, Klarna and Affirm who all enjoy a very large lead in customer numbers (both merchants and consumers).

Lynas Rare Earth (LYC.ASX – not owned) rose 20% over the month on the back of a continued recovery in rare earths prices. Malaysia extended Lynas' current operating license for a further 3 years (albeit with conditions) which removes some short-term risk the market had started to price into the share price. At current valuations, our assessment is that a lot has been priced into the Lynas' share price and we can find better value elsewhere.

Outlook

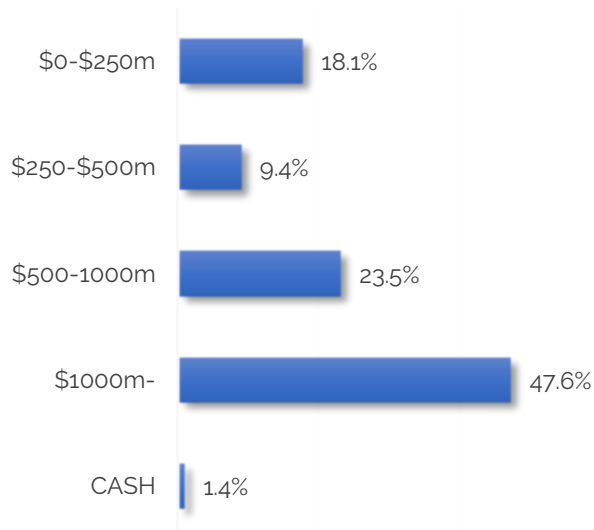
Smaller capitalisation stocks have traditionally been the market segment most prone to M&A activity. We are beginning to see signs of this re-emerging which has tended to play to the portfolio's strength in the past. Capital is also likely to be released to the market via IPO's and founder sell downs which we see as highly likely over the next year or so. Whilst the backdrop of extremely loose monetary policy has driven some areas of the market to speculative excess, there remain others where valuations and fundamentals are supported by cash flow and valuation.

Top 10 Holdings

Company Name	% Portfolio
Fletcher Building	4.3
Ht&E Limited	3.9
Mortgage Choice Ltd	3.8
Class Limited	3.7
Seven West Media Ltd	3.7
City Chic Collective	3.6
Healius	3.6
Breville Group Ltd	3.5
Asaleo Care Limited	3.5
Adbri Limited	3.0
Top 10	36.8

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)³

Pre-tax NTA ⁴	\$2.298
Post-tax NTA ⁵	\$2.270

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 January 2021

	1m	6m	1yr	2yr p.a.	Inception p.a. ⁶
Company ⁷	-0.5%	33.7%	9.6%	12.9%	8.0%
Benchmark ⁸	-0.3%	18.3%	9.2%	11.9%	7.1%

Past performance is not a reliable indicator of future performance.

⁶Inception date is 30th November 2017

⁷Calculated as the portfolio performance after fees excluding tax on realised and unrealised gains/losses and other earnings, and after company expenses

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

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