ASX: SEC

Investment Update

As at 31st March 2021

Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets[4]

$2.407

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

9.6%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	$2.14
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	$128.7m

[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 March was 2.2%, while the S&P/ASX Small Ordinaries Accumulation Index returned 0.8%.

Markets

The market trended higher over March as the economy gently came off life support (read Job Keeper and Job Seeker Covid 19 supplements) which started winding down at the end of March. It is worth reflecting that the absolute nadir of the market was almost exactly a year ago on March 23rd, 2020. The Small Ordinaries is up a lazy 52.1% since the end of March or 64.4% from the absolute bottom. It pays to be brave. The absolute panic that gripped markets between February and March of 2020 almost feels like something of a distant memory now that Covid 19 vaccines – having been created in record time - are being aggressively rolled out in major geographies. Governments now compete to have the most vaccinated populations.

Whilst governments compete on the health of their populations, Central Banks compete to bloat their balance sheets in a new experiment with finance called MMT (Modern Monetary Theory) – no not a new vaccine – but the idea that you can produce money ad nauseum without having any impact on its value. Precisely how a supposedly scarce resource (money) suddenly being made not scarce cannot have an impact on its value is a bit of a quandary. Never mind it seems to be working at the moment, so let's call it a theory and brandish it around like it's a new financial Magna Carta!

Although MMT adherents believe that inflation really is dead – simply because it has been dormant for a long time – (let's call them the new Vesuvians') the same certainly cannot be said for asset prices. The economic shutdowns over the past 12 months have been akin to a self-induced coma; in other words, the economy was deliberately slowed or paused to deal with the pandemic. The Government stimulus provided to re-awaken the patient, however, has been anything but a gentle resuscitation. The infusion of cash, the ultra-low interest rates, the deferral of tax collection, the early withdrawal of super, the payment of Job Keeper etc. has seen both the property and stock markets spring back to life. The further down the market cap spectrum you go, generally the less efficient the market gets. This also applies in a recovery scenario, and microcaps have exploded off the bottom with the most speculative names reaching new heights. Whilst we would be cautious on the most overinflated areas of the smaller companies space, there continue to remain pockets of attractive opportunities which we believe have not attracted the fickle attention of the market.

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The portfolio has generally been continuing to rotate into names that have lagged the re-opening of the economy or where we see more upside on a relative basis

Major Contributors for the Month

Mortgage Choice (MOC.ASX) was the largest contributor to the Fund, rising 64% over the month. MOC has been in the Fund for some time on account of the strong valuation support provided by the trailing commissions as well as the recovery in the housing and housing finance markets. MOC has around 3.4% of the mortgage market which was subscale in terms of its ability to securitise its own mortgages. REA Group (REA.ASX) made a takeover offer towards the end of March at $1.95 per share (a 66% premium to the pre-bid price) via a scheme of arrangement. No doubt a big part of the rationale here will be to increase their own circa 1.5% market share (under the Smartline brand) and enable the scale benefits that come with size.

Zip Co. (Z1P.ASX – not owned) declined 29% over March as the market worried about the possible re-emergence of inflation and consequent rate increases. Z1P was also to some extent unwinding a very strong price appreciation from earlier in the year when the stock had almost doubled over January and February. Whilst Z1P demonstrates very strong topline growth (as do many financial or near financial companies), profitability and cash flow remain ever elusive. It's amazing how much financing these non-finance companies need to sustain themselves. Our caution on this stock and indeed the entire BNPL sector is due to the fact none have been tested in a bad debt environment and the low entry barriers mean that their topline success will (and indeed does) continue to attract an ever-increasing number of competitors. Increasing competition usually does not lend itself to higher margins and higher returns.

Vista Group (VGL.ASX) added to performance after rising 26% over the month. Vista dominates the market for software in the global cinema exhibition, distribution and production markets with around a 40% global market. Unsurprisingly, the pandemic has had a highly detrimental impact on short-term trading as a very significant percentage of global cinema circuits were closed given the social distancing measures implemented by Governments. Despite this, Vista managed to keep cash burn to a very modest level. The business has circa 20 months of liquidity runway ahead of it at current burn rates which should significantly improve as the rollout of vaccines in its key market (North America and Europe/UK) see the gradual re-opening of circuits and the release of film content that has been shifted to the right since the pandemic. We see Vista as well placed to return to strong levels of profitability as the pandemic ebbs. At c2.5x historical revenue we also see the business as strongly undervalued on a through-the-cycle basis.

Major Detractors for the Month

Seven West Media (SWM.ASX) declined almost 14% over the month, having been a very strong contributor in recent months. We continue to remain positive on SWM's recovery prospects after it reported a result well ahead of market expectations as television advertising returned to growth during the 4Q of calendar 2020, the cost base was better controlled than expected, and the balance sheet is being de-leveraged. The business also announced a collaboration with Google and Facebook that should see a material revenue contribution which we view as a welcome and fair outcome. Seven continues to have upside from the recent improved ratings share translating into revenue share and potential newsflow around the divestment of the studios and/or towers and current sell down of its stake in Airtasker. In spite of SWM's strong share price recovery, it still trades on a mid-single digit EV/EBIT multiple which is well below Nine Entertainment (NEC.ASX).

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Geopacific Resources (GPR.ASX) detracted as it fell 17% over the month on the back of a modest retracement in the gold price, as well as holders worrying about the potential negative impact on the development schedule from PNG's deteriorating COVID-19 situation. We note however that activity on the island continues at pace with the earth works and mining contractor on site and able to mobilise personnel to Woodlark Island from the PNG mainland with a COVID-19 testing regime and quarantine procedure keeping the island free of infection. GPR have also pushed ahead with the order of the grinding mills which is on the critical path. We still expect GPR to close its agreed debt financing shortly (equity having been raised) and progress its construction of the Woodlark Island gold mine. GPR screens extremely cheaply on an EV/Reserve, EV/Resource and Price/NPV basis and the new Santa Barbera-sourced management team has extensive PNG operations and development experience at SBM.ASX's nearby Simberi operations.

Monadelphous (MND.ASX) declined 8% over the month. MND is somewhat idiosyncratic given that we have seen strong increases in most commodity prices and producers, and yet MND has declined over the quarter. MND reported a strong H1 2021 result driven by a rebound in work after Covid delays during the first half of calendar 2020. Their Engineering and Construction division reported revenue up 68.4%, although the Maintenance division declined 16% due to very strong comparative periods. With the mining sector undergoing rapid growth in WA, many companies are struggling to recruit sufficient staff with Covid 19 interstate migration limits placing constraints on companies' ability to hire from the East Coast. This is forcing a temporary shortage of skilled workers over in WA and many contractors are not able to take on new work due to current limitations. We believe MND have experienced the same issues, and thus current strong demand levels are not being translated into revenues. The decline in share price puts MND on 10x EBIT with a net cash balance sheet of $200m.

Outlook & Strategy

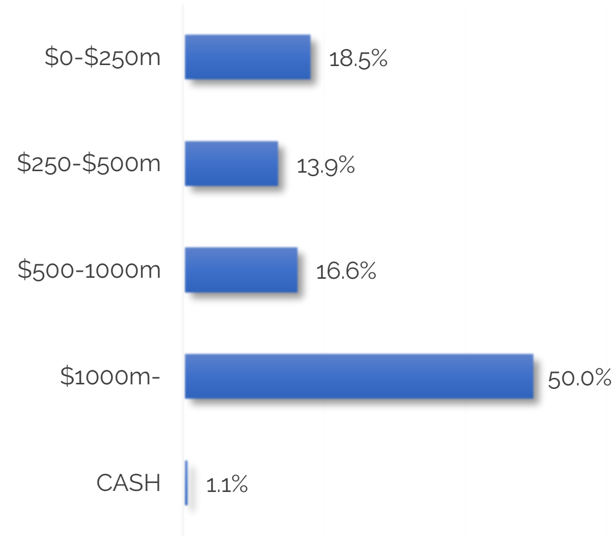
Smaller companies have significantly outperformed the large caps from the bottom of the market in early 2020. The raft of Government and Central Bank actions has assisted both the economy and stock price recoveries. In hindsight, it looks like the Government possibly did too much to stimulate the economy – hindsight is 20/20 however and this was by no means a foregone conclusion when these measures were being constructed. The Company has performed well out of the market nadir last year, but we are encouraged by the opportunities still presenting to us and continue to avoid what we see as over-hyped parts of the micro and smaller cap market. The Company has been the beneficiary of a number of smaller company takeovers over the past 3-4 months, and we see good reasons why this run is likely to continue based on the type of companies we invest in and the corporate appetite in the present environment. Despite the overall market's increase, segments of the market remain attractively valued on both a relative and absolute basis. Decent quality, high cash flow businesses with valuation underpinnings have not all become the current market darlings and it is here that we continue to hunt.

Top 10 Holdings

Company Name	% Portfolio
Mortgage Choice Ltd	5.0
Fletcher Building	4.4
Adbri Limited	4.1
Healius	3.6
Blackmores Limited	3.5
Seven West Media Ltd	3.5
Ht&E Limited	3.4
Class Limited	3.1
City Chic Collective	3.0
Breville Group Ltd	3.0
Top 10	**36.5**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)[3]

Pre-tax NTA[4]	$2.407
Post-tax NTA[5]	$2.344

[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 March 2021

	1m	6m	1yr	2yr p.a.	Inception p.a.[6]
Company[7]	2.2%	26.5%	73.0%	12.4%	9.6%
Benchmark[8]	0.8%	16.2%	52.1%	9.6%	7.5%

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

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