

Investment Update

As at 30th September 2021



Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets⁴
\$2.665

Company⁷ performance p.a.
(since inception)

12.1%

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 portfolio performance for the month of September was -0.7%, while the S&P/ASX Small Ordinaries Accumulation Index returned -2.1%. Over the past year the SEC portfolio has returned 44.7% outperforming the benchmark by 14.3%.

Markets

Markets declined both here and internationally over September after putting in a robust performance in the previous month. The Smaller Companies index was dragged down by materials, healthcare and software and services which took a breather after posting strong returns over the past year. The beaten down Energy sector bounced hard with oil and energy prices maintaining their upward trajectory and demand recovering in the Northern Hemisphere with economies re-opening. Oil prices are touching US\$80/bbl a level not seen since mid 2014 with US gas prices also back up to a 7 year high. Gas supplies appear to be extremely tight in Europe and the UK in particular causing some significant increases in prices in local markets.

Transport and travel names also performed well as investors started to look through to the Australian economy re-opening and the re-commencement of local and international travel (finally!). We believe we are in the midst of a massive spending shift from goods back to services. The synchronised global spike in demand for goods has strained global manufacturing from chips to automobiles and put significant upward pressure on freight rates and port logistics. As people are allowed to travel again, we would expect a significant reversal back to services and in particular travel and leisure which has been suppressed by Government mandated travel restrictions. Early signs in New Zealand showed the big jump in travel demand massively exceeded the travel undertaken in 2019 and assuming capacity is restored it would seem likely that we will see the same development in Australia.

The other major issue investors are grappling with remains inflation and the long-term bond rates implied by rising inflation. So far, the official narrative from Central Bankers remains that this increase in inflation is temporary, however we remain sceptical. We use an 8% discount rate in all our models and implicit in this is a 3% 10-year bond yield (vs. around 1.5% as we write this) and an equity risk premium of 5%. We think rates are likely to trend back up over time and importantly our valuations assume this to a reasonable extent. We would suggest that investing in stocks now whose sky-high valuations are predicated on the assumption that rates stay sustainably this low for

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a long time from here really is metaphorically speaking akin to reaching down in front of a bulldozer to pick up pennies.

Major Contributors for the Month

Flight Centre (FLT.ASX) was the most significant contributor to the Company which took off over September returning 30%. FLT reported a depressed set of earnings in August as travel volumes cratered over the previous twelve months but indicated that they were starting to see a reasonable re-bounce in both corporate and retail bookings towards the end of the fiscal year. FLT has continued to win significant business in FCM – their corporate side - whilst undergoing heavy restructuring on their retail side. This will mean earnings and margins could well re-bounce to levels higher than they were prior to Covid 19 restrictions taking effect.

Vista Group (VGL.ASX) was the next largest contributor as this world leading cinema ERP software business continued its recovering trajectory as cinemas in the Northern Hemisphere re-open. VGL announced the launch of Vista Cloud in late August after beta testing with some of their customers. This should offer the group opportunities to further expand their significant market share and increase their revenue from hosting revenue streams as customers outsource the running of the software to VGL to save on-premise capex budgets. The early signs from the Cinema industry's re-opening remain very positive. VGL is trading on sub 20x partially recovered EV/EBIT 2 years out and a fraction of the revenue multiples of its software peers.

Technology One (TNE.ASX) gained 15% over the month as the company announced the acquisition of Scintia Plc – a UK based Syllabus software optimisation program for GBP12m. Whilst this was a small deal for TNE, brokers took the chance to upgrade target prices based on the company's continued move to a SAAS (Software as a service) offering. TNE remains one of Australia's outstanding home-grown technology success stories – genuinely competing against and beating global giants SAP and Oracle in Local Government and Education ERP software tenders. TNE's balance sheet is solidly net cash, cash conversion is amongst the best in the smaller companies universe however TNE's valuation is now starting to look more full to us on a relative basis.

Major Detractors for the Month

Iress Ltd (IRE.ASX) declined 21% over the month as Swedish private equity firm EQT announced they were unable to agree a final bid price with the Iress Board. EQT had previously indicated an indicative price of \$15.75 per share plus the interim 16c per share dividend. IRE remains a highly cash generative technology business with extremely entrenched customers. Whilst it is disappointing that no agreement could be reached from an investor's point of view, we nonetheless believe the company remains a strong franchise with decent investment appeal. The company has commenced the share buyback announced at the time of their full year results and has bought back around \$20m of the total of \$100m announced.

Seven West Media (SWM.ASX) detracted as the share price retraced 18% over the month on limited news flow. As we have discussed in previous monthlies, SWM is one of the cheapest media franchises in the country with a strong management team who are executing on a cost out and delevering of the company's balance sheet. SWM has attracted a significant increase in their digital audience on their BVOD (broadcast video on demand) services after their success in showcasing the Olympics. How they monetise this and control costs remains crucial to the medium-term story. We view their business as being central to any likely media consolidation in Australia, yet the

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company trades on a mere 4.5x EV/EBIT.

Class Ltd (CL1.ASX) declined 12% during the month again with limited obvious catalyst other than the market's simple ennui with small technology firms. We remain attracted to the high customer retention rate at Class (99.1%) and the strong organic growth prospects they have in their product adjacencies; Class Portfolio and Class Trust as well as Doc tech under their NowInfinity brand. CL1 continues to look extremely attractive compared to most technology firms listed in the smaller companies space on just 14x our estimated FY22 EV/EBIT.

Outlook & Strategy

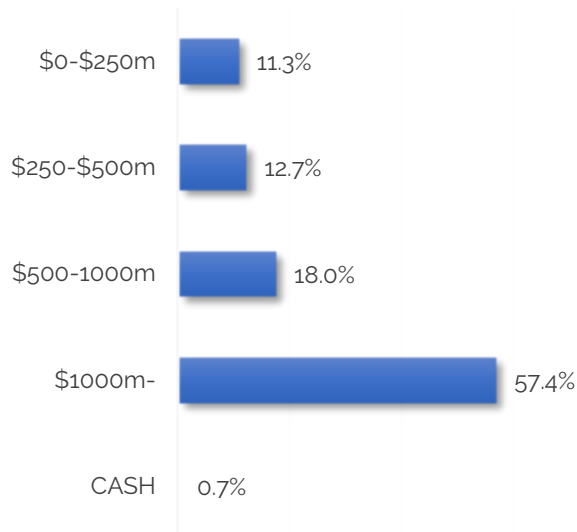
As has probably become apparent from the commentary above we see a number of significant economic pivot points approaching. The first is a consumer spending swing back to services and away from goods. The second pivot point is the possibility of higher medium term interest rates and more persistent inflation than our Central Bankers would have us believe. Change leads to opportunity – the key is to be prepared and willing to make investment changes. We remain surprised, although we have been around long enough not to be so, by the over-enthusiasm investors appear to have for money-losing disruptors in the small and mid-cap space. We are however more convinced by long-term investment history which suggests that unless new ideas make money in a reasonable timeframe, the fascination eventually wears thin, and investors will jump on board the next new thing leaving the old idea to wither in the market's basement of forgotten dreams.

Top 10 Holdings

Company Name	% Portfolio
Flight Centre Travel	5.8
Blackmores Limited	4.2
Adbri Limited	3.8
Vista Group Int Ltd	3.8
Fletcher Building	3.7
Iress Limited	3.6
Corp Travel Limited	3.3
Bega Cheese Ltd	3.3
IOOF Holdings Ltd	3.3
Healius	2.9
Top 10	37.7

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)³

Pre-tax NTA⁴	\$2.665
Post-tax NTA⁵	\$2.546

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 30th September 2021

	1m	6m	1yr	3yr p.a.	Inception p.a. ⁶
Portfolio⁷	-0.7%	14.3%	44.7%	12.1%	12.1%
Benchmark⁸	-2.1%	12.2%	30.4%	9.4%	9.7%

Past performance is not a reliable indicator of future performance.

⁶Inception date is 30th November 2017

⁷Calculated as the Company's investment 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. All p.a. returns are annualised

Disclaimer

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