

## Performance as at 31st January 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a <sup>3</sup>
Fund <sup>1</sup>	-6.2%	-1.8%	37.3%	23.9%	15.0%	16.3%
Benchmark <sup>2</sup>	-9.0%	-8.0%	6.7%	10.1%	9.6%	9.0%
Difference	2.8%	6.2%	30.6%	13.8%	5.4%	7.3%
Microcap Index <sup>a</sup>	-7.7%	-4.1%	27.7%	28.4%	15.1%	15.5%

<sup>1</sup> Sphera Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes.

<sup>2</sup> Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

<sup>3</sup> Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

<sup>a</sup> Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.



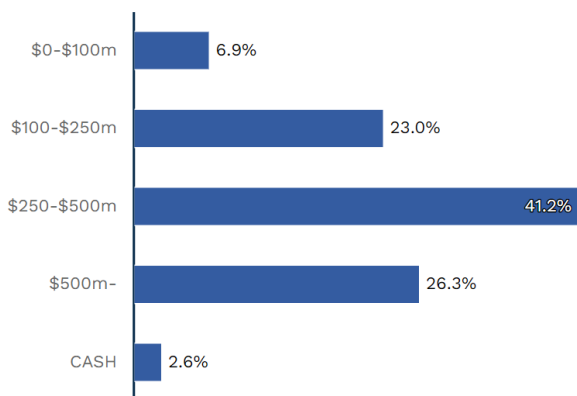
### Overall Commentary

The Sphera Australian Microcap Fund returned -6.2% (after fees) over the month of January, outperforming the Small Ordinaries Accumulation Index by 2.8%.

### Top 5 Holdings

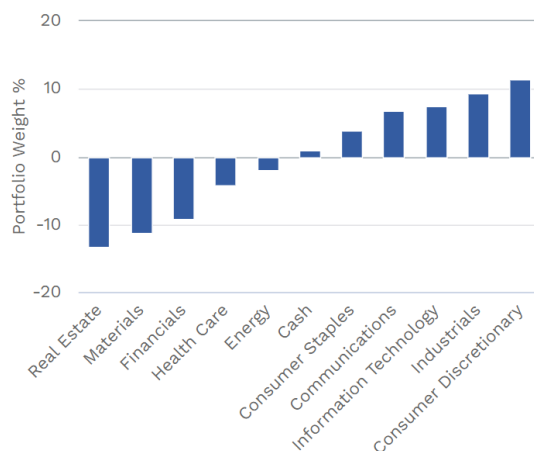
Company Name	% Portfolio
Class Limited	5.8
Michael Hill International Limited	5.7
Helloworld Travel Limited	5.4
Supply Network Limited	5.3
Nzme Limited	5.2
<b>Top 5</b>	<b>27.3</b>

### Market Cap Bands



Source: Sphera Asset Management

### Active Sector Exposure



Source: Sphera Asset Management

## Markets

The local small and midcap indices were both materially lower over January – down close to 9% – as the market absorbed the continued newsflow around inflation and the reasonably material adjustment to interest rate outlooks by Central Bankers. As children who lived through the 80's, we had been suggesting that inflationary pressures were more than just transitory impacts of a post Covid crisis. Watching cafés raise prices 5-15%, cleaners readjust prices over 10% and seeing unions striking for better pay conditions, all suggested to us that cost increases were broad based and that labour rates were heading higher. It is somewhat ironic that inflation is precisely what Central Banks have been trying to engender for some time via the consistent debasement of currencies. This deflates the real value of the debt balloons which Governments around the world have taken on and sold predominantly to their own Central Banks. As rates rise, the value of bonds falls. This doesn't bode especially well for the balance sheets of Central Banks, all of which are now bloated with super low yielding bonds and all of which are now decreasing in nominal (and real) value as longer-term bond rates tick upwards.

In a falling rate environment, momentum is your friend. The longer the duration, the growthier the company the more the stock can rise. If you use spot rates in your valuations even small decreases on a very small discount rate base can see sharp upward re-valuations in companies. This had led to quite a few smaller companies that we felt were – to put it mildly – trading significantly above intrinsic value. You could easily use a harsher description. The list of some of the worst hit stocks in January reads like an honor roll of companies with large market caps on small revenue bases, with even smaller earnings bases. On the other side of the ledger, valuation almost became a fashionable word. This is what makes investing in smaller companies generally an enjoyable occupation with volatility often creating some great opportunities.

## Major Contributors for the Month

**Austin Engineering (ANG.ASX)** ANG is a producer of mining equipment focussed on truck bodies, mobile water tankers and other mining metal related wear parts. With the commodities boom underway, mining service companies (who have been able to pass on inflation-related costs) have seen strong order book recoveries. ANG pre-released a strong trading update in January upgrading H1 EBITDA guidance by 10% (doubling EBITDA from last year), as a result the shares rose 18% over January aiding the Fund's performance materially.

**Supply Network (SNL.ASX)** is the leading supplier of aftermarket bus and truck parts in Australia and New Zealand. SNL released market guidance for H1 2021 late in January re-affirming previous guidance for earnings of \$9.5m NPAT (up 55% on previous years H1) with sales growth in excess of 22% YoY all of which is organic. The prior year's earnings base was not a weak base and thus these are truly impressive YoY growth numbers. SNL rose 4% over January in a sharply down broader market adding to performance.

**Horizon Oil (HZN.ASX)** rose around 9% over January on the back of the continued rise in Oil prices. The WTI oil price rose 15% over January to close the month at US\$86.80 a barrel. Although HZN has partially hedged its oil production over 2/3 remains unhedged. At the end of the month HZN released its quarterly production which showed the continued strong cash generation from their core assets in New Zealand and China, the balance sheet now reflecting a healthy net cash position of US\$14m. At current oil prices HZN should produce revenue of over US\$100m with a healthy operating cashflow of US\$60-70m on a current EV of around A\$150m.

## Major Detractors for the Month

**Nitro (NTO.ASX)** was the largest detractor as the stock fell 25% over January. NTO declined with other technology related names. What has attracted us to NTO are the market share gains they are making against industry leader Adobe who continue to seed share to Nitro Pro. Nitro has expanded its product suite from document productivity software (similar to Adobe Acrobat) into e-signing, which we see as a potentially very large industry. NTO has recently strengthened their position in e-signing with the acquisition of European based Connective. With a high client retention rate (over 95%) and a business model which has largely transitioned from on-premise to a SAAS model, we believe the business will ultimately prove to be a successful investment despite the pull back in the share price. NTO's balance sheet is well funded with over \$60m of net cash and it trades on just 4x EV/Sales.

**Vista Group (VGL.ASX)** detracted from performance as the share price declined 15%. We have spoken about VGL before and its strength in the cinema market as the leading provider of ERP software to cinema exhibitors. Whilst Omicron has tempered investors views on the speed of re-openings across Europe, we are of the view that appetites for sustained lockdowns amongst countries is rapidly waning and that VGL will see a dramatic improvement in prospects this year. The business remains in a strong position with a net cash balance sheet and is trading on around 14x recovered EV/EBIT.

**Brainchip Holdings (BRC.ASX – not owned)** surged 110% over January on news that it had been granted a US patent for its AI neuromorphic chip. BRC makes a low powered AI chip that could have applications in the aerospace and automobile industries. At present BRN has virtually no revenue, a skinny balance sheet (US\$23m net cash as at September 2021) and is losing a significant amount of earnings and cash flow. Whilst the ultimate product may be a success with an enterprise value approaching \$3.0 billion we continue to believe there is better investment alternatives elsewhere.

## Outlook & Strategy

Periods like the market sell off in January serve as a useful reminder that the 'animal spirits' of investing need to be grounded by logic, reasoning, and fundamentals. The market is re-appraising the medium-term interest rate outlook in the absence of Central Bank QE and is waking up to the prospect that this will see 10-year bond yields rise from their all-time lows plumbed in CY2021. Whilst volatility seems unpleasant in the short term, rotations like the ones we have just seen tend to provide opportunities for our style of investing and should see a more rational approach to capital allocation in the smaller companies space. We have long argued that very low interest rates for a sustained period can lead to misallocation of capital. The funding of loss-making new enterprises against legitimate incumbent businesses for example, should come to an end if there is no reasonable prospect of them turning a profit. The market has been fixated by the idea of new technologies and business models for the past few years and been willing to fund ever expanding losses with a dim future prospect of earnings and cash flows. With rates on the rise this exuberance is likely to be tempered favouring strong existing business models on attractive valuations.



# Sphera Australian Microcap Fund

ARSN 611 819 651 | APIR WHT0066AU | mFund SPM01

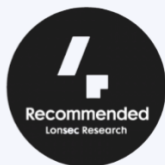
## Platform Availability List

If a fund is not available on your preferred platform, please contact us. Please check with your platform for minimum investment requirements and fees.

<a href="#">Aegis</a>	<a href="#">FNZ Group</a>	<a href="#">MLC Navigator</a>	<a href="#">Praemium</a>
<a href="#">Asgard</a>	<a href="#">HUB24</a>	<a href="#">MLC Wrap</a>	<a href="#">Premium Choice</a>
<a href="#">BT Panorama</a>	<a href="#">IOOF Portfolio Service</a>	<a href="#">Netwealth</a>	<a href="#">Wealth02 uXchange</a>
<a href="#">BT Wrap</a>	<a href="#">IOOF Pursuit</a>	<a href="#">OneVue</a>	
<a href="#">DPM</a>	<a href="#">Macquarie Wrap</a>	<a href="#">PowerWrap</a>	

Sphera Australian Microcap Fund	
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Investment Objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term
Investing Universe	Primarily listed companies outside the top ASX 250 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Holdings	Generally 20-65 stocks
Distributions	Annually
Fees	1.35% p.a. management fee & 20% performance fee of the Fund's excess return versus its benchmark, net of the management fee
Cash	Up to 20% cash, typically 5% - 10%
Expected Turnover	20% - 40%
Style	Long only
APIR	WHT0066AU
Minimum Initial Investment	\$25,000

## Fund Ratings



## Further Information

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311 or email [distribution@pinnacleinvestment.com](mailto:distribution@pinnacleinvestment.com)

## Disclaimer

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