Spheria Australian Microcap Fund

ARSN 611 819 651 | APIR WHT0066AU | mFund SPM01

Performance as at 31st August 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Fund[1]	4.3%	1.4%	5.6%	19.6%	12.8%	14.5%
Benchmark[2]	0.6%	-2.6%	-14.7%	4.1%	6.9%	7.1%
Difference	3.7%	3.9%	20.3%	15.5%	5.9%	7.4%
Microcap Index[a]	1.7%	-5.4%	-2.3%	16.1%	13.8%	12.2%

1 Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes.
2 Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.
3 Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.
a Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.

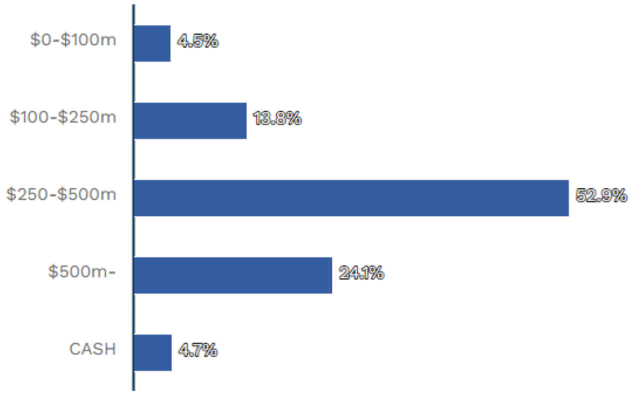
Overall Commentary

The Spheria Australian Microcap Fund returned 4.3% (after fees) during the month of August, outperforming the ASX Small Ordinaries Accumulation Index by 3.7%.

Top 5 Holdings

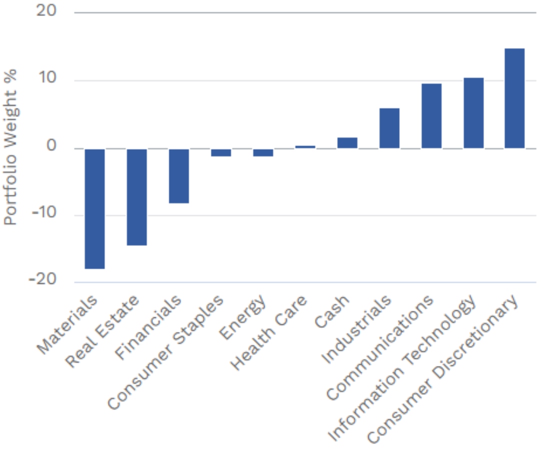
Company Name	% Portfolio
Michael Hill International Limited	5.6
Ht&E Limited	5.2
Vista Group International Limited	4.9
Supply Network Limited	4.5
MaxiTRANS Industries Limited	4.4
Top 5	**24.5**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

The Spheria Australian Microcap Fund returned 4.3% (after fees) during the month of August, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 3.7%.

The Fund performed well in August with results generally better than expected and takeover activity in the beaten-up technology sector aiding performance with a private equity group, Potentia Capital, conducting an off-market raid on Nitro Software (NTO) one of our key holdings at a significant premium to its last traded share price. The lithium sector continues to expand which has detracted from relative performance, but we note most of these miners are not producing, and the lithium price feels like it has gotten well ahead of fundamentals – this happened in 2019 as well. On the economic front, the combination of higher mortgage rates, higher fuel prices and rampant inflation has yet to significantly impact consumer spend with countervailing forces of full employment, strong wages growth and solid household balance sheets providing a buffer for now, and household credit still flowing. For what it's worth most of the companies we talk to are trading relatively well and balance sheets afford a solid buffer to ride out the highly anticipated economic downturn.

Major Contributors for the Month

Positive performance contributions from companies owned included:

Nitro Software (NTO.ASX) – jumped 37% after an off-market raid by a private equity firm, Potentia Capital, at $1.58 which was a significant premium to the undisturbed price. We partially sold into the raid for liquidity reasons but remain supporters of the company as we believe the product (PDF software) is excellent and the pivot in strategy to bring forward profitability (over growth) as sensible. This change in strategy clearly did not mesh well with some investors who sold the company down aggressively which has facilitated the opportunistic takeover approach. We feel Potentia Capital will need to substantially increase its offer to gain control of the company. At worst, if they decide not to, the offer highlights value in the asset and its broader strategic appeal.

Ht&E (HT1.ASX) – share price rallied 17% from a low base after reporting a solid 1H22 financial result. The radio industry continues to be a resilient advertising medium globally due to stable audiences with a growth angle into podcasting and digital platforms (e.g. HT1 owns the IHeart Radio licence in Australia). HT1's balance sheet is sound with less than $80m of net debt after extinguishing large tax liabilities during the period and acquiring the regional radio assets of Grant Broadcasting. Post balance date, HT1 will receive about $8.8m from the divestment of its final balance of Luxury Escape shares and has again put its 25% stake in Soprano up for sale, which could be worth upward of $75m. HT1 is trading on an EV/EBIT multiple of about 5x.

MaxiPARTS (MXI.ASX) – share price increased 11% over the month after producing a reasonable result. MXI distributes and sells commercial truck and trailer parts in Australia, which is a relatively resilient and growing industry. The leading player in a fairly fragmented market is SNL which is has a similar annualised revenue base of just under $200m. The key difference between the companies is that MXI is generating EBIT margins of 5-6% whereas SNL is around 15%. Whilst we believe SNL's margins are somewhat elevated, we feel there is room for MXI to increase its margins from a low base as it has scaled up with the acquisition of Truckzone last year (factored into that approximately $200m of annualised revenue). At a 6% EBIT margin, MXI is trading on only 6x EV/EBIT and has a slight net cash balance sheet.

Major Detractors for the Month

Vita Group (VTG.ASX) – declined 20% after reporting a weak FY22 result. The company has returned 52.3cps (75cps including franking) to shareholders since it completed the sale of its Retail ICT operations to Telstra late last year. The company reported $18m of net cash (including term deposits less debt) at 30 June 2022 but its continuing operations, Artisan Aesthetics Clinics drained around $10m of cash during the year; whilst this was heavily impacted by COVID-19 challenges including clinic closures and lockdowns etc the group is anticipating that breakeven on an EBITDA basis will not occur until FY24. This is very disappointing and begs the question why a business with $30m of revenue in a normal year ($25m in FY22) cannot make money when competitors with $1-2m in turnover are profitable, otherwise they would not exist? We feel the company is headed in the wrong direction and a major strategy overhaul is necessary before it bleeds too much more cash.

Liontown Resources (LTR.ASX, Not Owned) – which we do not own rallied strongly (+31%) during the month and now has a market capitalisation of nearly $4bn, like many of its compadres in the small cap market. The company has no revenue but has begun construction of processing and facilities for its Kathleen Valley Lithium mine in WA. First production is expected in late FY24. We feel the lithium price is trading well ahead of fundamentals and there are risks with investing in this kind of project given the timeline to production and large valuation already ascribed by the market.

Sayona (SYA.ASX, Not Owned) – which we do not own rallied strongly (+51%) during the month and now has a market capitalisation of nearly $3bn. SYA acquired its flagship project (75% ownership), North American Lithium (NAL), in 2021 which is essentially an old hard rock lithium mine in Canada that is being restarted. Over $400m has been invested in a concentrator, mining operations and a carbonate plant with first spodumene production expected in 2023 and first refined product planned by 2025. Similar to LTR, we feel the risk-reward equation for investors is unfavourable but it doesn't mean the share price won't continue to rally given the strength of the narrative.

Outlook & Strategy

Higher interest rates cleaned out pockets of hyper speculation in the small cap market this calendar year, however, there remains over-exuberance with many higher PE names still trading on crazy multiples and the lithium sector continuing its rapid ascent but with very few (if any) of the miners producing yet. Recent M&A activity in bombed out small cap technology names that are losing money including Nearmap and more recently Tyro Payments seems to be reflating that segment of the market. This could be a difficult environment for us to perform on a relative basis particularly if cash burners find favour again. Nonetheless, we think the broader market sell-off presents a great opportunity for longer term alpha generation with valuation multiples pricing in a very dire economic scenario.

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.

- Aegis
- Asgard
- BT Panorama
- DPM
- FNZ Group
- HUB24
- IOOF eXpand
- Macquarie Wrap
- MLC Navigator
- MLC Wrap
- Netwealth
- OneVue
- PowerWrap
- Praemium
- Premium Choice
- Wealth02 uXchange

Spheria 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

SPHERIA
ASSET MANAGEMENT

Spheria Australian Microcap Fund

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Fund Ratings

Zenith RECOMMENDED

Recommended Lonsec Research

Further Information

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311 or email distribution@pinnacleinvestment.com

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Link to the Target Market Determination
For historic TMD's please contact Pinnacle client service Phone 1300 010 311 or Email service@pinnacleinvestment.com
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