Spheria Australian Microcap Fund

ARSN 611 819 651 APIR WHT0066AU

Performance as at 30th September 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Fund[1]	-7.5%	3.1%	-4.8%	15.1%	10.7%	12.9%
Benchmark[2]	-11.2%	-0.5%	-22.6%	-0.8%	4.1%	5.0%
Difference	3.7%	3.6%	17.8%	15.9%	6.6%	7.9%
Microcap Index[a]	-9.8%	4.8%	-18.2%	10.1%	10.8%	10.2%

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.

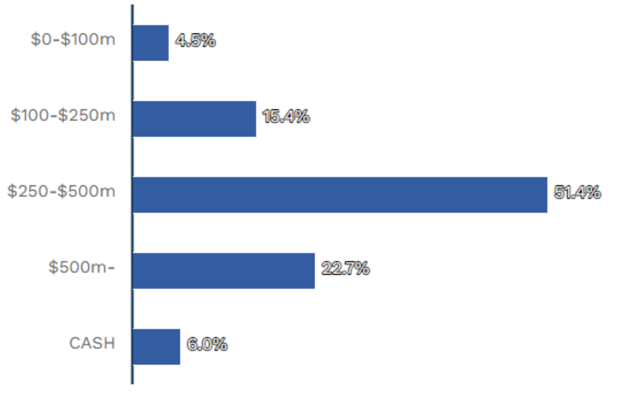
Overall Commentary

The Spheria Australian Microcap Fund returned -7.5% (after fees) during the month of September, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 3.7%.

Top 5 Holdings

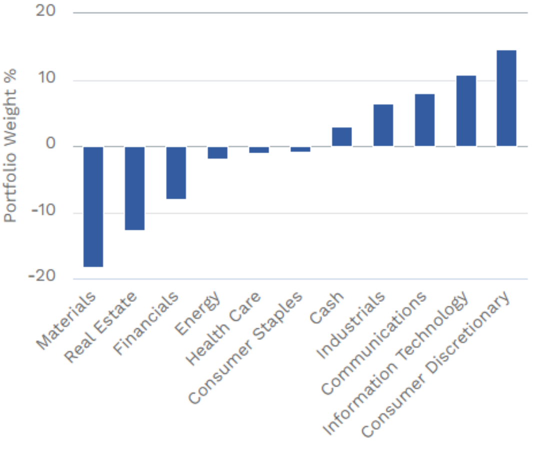
Company Name	% Portfolio
Michael Hill International Limited	6.1
Nitro Software Limited	4.6
Supply Network Limited	4.6
Vista Group International Limited	4.6
Ht&E Limited	4.4
Top 5	**24.3**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

Markets struggled over September after the respite in July and August. The Small Ordinaries Accumulation Index declined over 11% with the Mid-Small Index marginally less impacted falling 9.0%. Globally markets were also well down over the month. Bond yields rose in the US and more modestly in Australia such that 10-year yields are now close to 4% in both countries. Other world political events haven't calmed investors nerves either with energy prices re-asserting themselves and a great deal of angst present with companies we have spoken to around rising energy prices for consumers.

Having said this, we have to acknowledge that markets are now down broadly 20-25% year to date with smaller and microcaps worse affected than Australian large caps. A lot of the present risks are known to some extent – inflation, rising rates, high energy prices and macro uncertainty around the Ukrainian situation. The extreme outliers in smaller companies – the large pockets of overvaluation in speculative growth names – have largely come back down to earth. During September for example several smaller company names were suspended and subsequently removed from indices. These stocks included AVZ Minerals (AVZ.ASX), BWX (BWX.ASX) and Firefox (FFX.ASX) which in aggregate represented close to 1.2% of the small cap index. Investors are now talking about valuation and discount rates again and a more sensible economic lens is being used to allocate capital. Whilst the macro environment continues to present risks, it is worth remembering that fortune favours the intelligently brave and much better opportunities appear at times like these than when there is a positive consensus around buying an over-promoted growth market.

With that in mind, and a degree of conservatism in our forecasts, we continue to look for the best opportunities across the market and to try to sensibly rotate our portfolios into opportunities that we either thought were too expensive before and / or had material earnings risks.

Major Contributors for the Month

Positive performance contributions from companies owned included:

Michael Hill International (MHJ.ASX) – rose 7.5% in September, in contrast to the broader market which fell during the month. MHJ announced their annual results at the end of August and as has been the trend for the last two years, continue to drive earnings growth ahead of revenue, seeing margins expand. Despite a significant number of store days being lost due to COVID-19 lockdowns at the start of the financial year, group revenue grew 7% and EBIT grew 11.1%. This was driven by continued store productivity, growth in digital, and a 76% growth in loyalty members. The balance sheet finished the financial year with ~$96m of net cash and as such the company announced a share buy-back of up to 5% of the company's issued capital to deliver further earnings accretion to long term shareholders. Despite the impressive results and strong balance sheet, the company is trading on ~4x EV/EBIT and yielding over 7%.

Nitro Software (NTO.ASX) – remained flat over the month but outperformed as the market fell in September. As discussed in last month's commentary, NTO received an off-market offer by a private equity firm Potentia Capital at $1.58 which saw the share price hover around these levels over the month. Despite Nitro rejecting the Indicative Proposal on the belief the offer undervalues the company investors will await to see if another bid is proposed. We continue to remain supporters of the company as we believe the product (PDF productivity and e signing software) is excellent, the client base is strong, and the product retention is high. We are supportive of NTO's earlier pivot to profitability and positive cashflow over high revenue growth at disproportionate cost. Our sense is the current offer is too low given the recurring nature of most of the company's revenue, the growth potential and a well-funded balance sheet. At an EV/Sales multiple of around 4x it remains lowly priced for a global growing SaaS business.

Supply Network (SNL.ASX) – was flat over September outperforming the broader market. SNL is a name we have held in the mandate for several years and has been a strong outperformer with the share price almost tripling over the last 5 years. This has been driven by double digit revenue growth as the company continues to win market share in the aftermarket bus and truck parts market. The management team is highly conservative and focused purely on driving growth with minimal M&A to achieve their results. SNL trades on around 13x ebit but has almost no gearing and continues to grow share organically. We remain a fan of this business in the long term.

Major Detractors for the Month

Ht&E (HT1.ASX) – fell over 18% in September after performing strongly in August following their solid 1H22 financial result. As discussed in last month's commentary, the business has a sound balance sheet with less than $80m of net debt and has recently acquired the regional radio assets of Grant Broadcasting, to drive revenue synergies through operating both the metropolitan and regional radio networks. We feel the selloff reflects the macro environment, with investors worried about a pullback in advertising spend as a result of a slowdown in economic growth. However, in September HT1 reconfirmed +6-8% revenue in Q3 and solid revenue growth in Q4 and costs remain in line with guidance. The business is trading on an EV/EBIT of ~5x with a 25% stake in Soprano that could be worth upward of $75m.

Vista Group International (VGL.ASX) – fell over 19% in September despite recording a strong interim result at the end of August. The business was heavily impacted by COVID-19 as movie goers and the production of movies ceased due to worldwide lockdowns. The business has rebounded in 2022 with revenue growing almost 40% and recurring revenue growth slightly stronger. The business has also managed cashflow with only a $0.1m cash burn over the last 12 months. With moviegoer sentiment recovering and the pipeline of new films looking strong, we feel VGL is well placed to benefit from this.

New Hope Coal (NHC.ASX, Not Owned) – which rallied strongly (+28%) during the month following the release of their FY22 result. Similar to other coal names, NHC has benefited from the record coal prices in the last 12 months, with the company recording record earnings and cash flow as a result. The industry has been underinvested and has seen coal companies like NHC benefit from this. We have avoided owning names like New Hope Coal due to ESG concerns and at this stage of the cycle are weary of jumping into names where commodity prices are at all-time highs and any reversal could see shares linked to the commodity fall too.

Outlook & Strategy

It's always hard to be positive when you are sitting in a morass of negativity about markets. However, most great investors have made money betting against a fearful crowd. Over time, it's been proven that it's hard to time markets as we are overly prone to emotion and secondly that there have been few places to invest that have out earned the market as an asset class. Whilst there are many likely negatives it's worth remembering that we are buying individual businesses with, in some cases, innovative and adaptive management teams who have dealt with challenging environments before. We also need to keep in mind that a lot of the de-rating of reasonable companies has now put many of the companies we own on low to mid-single digit EV/EBIT multiples. Couple this with bullet proof balance sheets and we feel comfortable that returns will reward investors over time. Finally, there is some evidence that the pent-up inflationary forces we are dealing with could abate somewhat which may ease the rise of longer-term interest rates providing the market with some respite in time.

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

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ARSN 611 819 651 | APIR WHT0066AU | mFund SPM01

Fund Ratings

Further Information

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

Disclaimer