Spheria Emerging Companies Limited ASX: SEC

Investment Update 28 February 2023

Overall Commentary

The Company's performance for the month of February was -2.4% (after fees) outperforming the S&P/ASX Small Ordinaries Accumulation Index which declined 3.7%.

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share Price	$1.93
Inception Date	30 November 2017
Listing Date	5 December 2017
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Dividends Paid	Quarterly
Management Fee	1.00% (plus GST) per annum[1]
Performance Fee	20% (plus GST) of the Portfolio's outperformance[2]
Market Capitalisation	$116.1m

[1] Calculated daily and paid at the end of each month in arrears.
[2] Against the Benchmark over each 6-month period to a high-water mark mechanism

Performance as at 28 February 2023

	1 Month	3 Months	1 Year	3 Years p.a.	Inception p.a[3]
Company[1]	-2.4%	1.5%	-8.2%	10.4%	6.3%
Benchmark[2]	-3.7%	-1.2%	-8.0%	4.2%	3.9%
Difference	1.3%	2.7%	-0.3%	6.1%	2.4%

[1]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
[2] Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.
[3] Inception date is 30 November 2017. Past performance is not a reliable indicator of future performance. All p.a returns are annualised.

Net Tangible Assets (NTA)[1]

Pre-Tax NTA[2]

2.210

Post-Tax NTA[3]

2.226

[1] NTA calculations exclude Deferred Tax Assets relating to capitalised issue related balance and income tax loses.

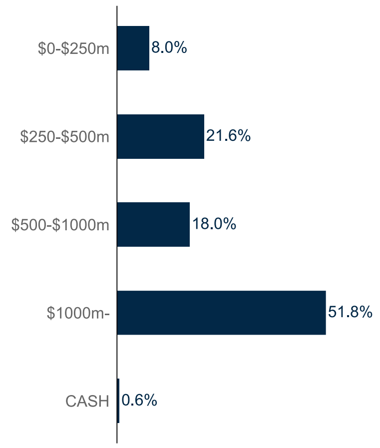
[2] Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.

[3] Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings.

Top 10 Holdings

Company Name	% Portfolio
Blackmores Limited	4.3
IRESS Limited	4.2
Nitro Software Limited	4.1
InvoCare Limited	4.0
Insignia Financial Limited	3.6
Breville Group Limited	3.5
Technology One Limited	3.5
Bega Cheese Limited	3.5
Flight Centre Travel Group Limited	3.4
Michael Hill International Limited	3.2
Top 10	**37.3**

Market Cap Bands



Source: Spheria Asset Management

Markets

Again, the smaller end of the market fell more than the larger end with the S&P/ASX 100 index down only 2.4% in February. This trend began at the beginning of last year with the relative underperformance now having extended to greater than 20%.

The reporting season was particularly “bizarre” with share prices hammered on any glint of negativity in a result. To us it feels like the market is becoming even more short term in nature which presents opportunities for those with a long-term investment horizon.

Major Contributors to Performance

Over the month the largest contributors to performance were A2B Australia (A2B.ASX, +20%), Smartgroup Corporation (SIQ.ASX, +13%) and Flight Centre Group (FLT.ASX, +19%).

A2B Australia (A2B.ASX) – share price rose 20% post the release of their first half 2023 result. The business returned to positive operating performance across all metrics versus pcp after being heavily impacted by COVID travel restrictions. Revenue rose 21% and the company reported a $3.7m profit after several years of losses. Fleet numbers and total fares increased substantially, with fares processed returning to 90% of pre-COVID levels for the six months. In the month of December alone fares returned to 99.8% of pre-COVID levels. Revenue is highly correlated to fares processed and fleet growth. Given the right-sized cost base it is possible that A2B’s earnings will revert to levels above that of pre-COVID levels in the next 6 to 12 months. The business also has significant property assets valued at over $100m, pre the sale of one asset which was sold in December for $19m. Post settlement the company will have a net cash balance sheet in excess of $12m. The business is trading on about ~4x normalised EV/EBIT, excluding the value of the remaining surplus property.

Major Detractors from Performance

The largest detractors were InvoCare (IVC.ASX, -18%), City Chic Collective (CCX.ASX, -28%) and Blackmores (BKL.ASX, -9%).

Invocare (IVC.ASX) – share price fell around 18% during February with most of the decline being post the release of their CY22 financial result. As we had been anticipating, the business delivered strong top line growth (+12%), benefiting from unusually high excess deaths in key markets, a trend that has been in place for the last 18 months or so. However, the business was unable to convert this into operating leverage with costs rising 13% and capex remaining very elevated. The result was disappointing given the amount of capital that has been invested into the business over the last few years to refurbish funeral homes and upgrade technology to deliver greater efficiency. Whilst some of the cost increases were justifiable given labour market tightness, the inability to recover cost increases via higher prices was more technology and management related, in our opinion. Continued elevated capex (~$70m in CY23) and discussion of “overseas acquisitive” growth rightly spooked the market and exacerbated the share price decline. Despite this we view IVC as a high-quality asset with a difficult to replicate geographic footprint, that has infrastructure like dynamics in a growing market which is duopolistic across many facets of its business and regions. After month end IVC was subject to a sharemarket raid from a private equity group at $12.65 (+40% premium to the last traded price) which acquired a 19.9% holding and put forward a non-binding indicative proposal to acquire all remaining shares at that same price. We believe it is in the shareholders’ best interests to pursue this approach and extract the highest price possible.

Outlook & Strategy Going Forward

Every downturn there seems to be a move toward “perceived” safety with multiples for defensive type companies blowing out to inconceivably high levels, perhaps this to some extent explains the rotation away from small caps to large cap companies. Given the extent of the rotation and demarcation in valuations we believe there is a high probability of making significant returns from the smaller end of the market relative to the larger end in the next few years.

Our relative performance is good, and we are investing for better absolute returns ahead.

Fund Ratings

Zenith RECOMMENDED

Recommended Lonsec Research

Fund Ratings

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311

Disclaimer

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