

Overall Commentary

The Company performance for the month of January was 7.1% outperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.5% (after fees).

Company Facts

Investment Manager	Sphera Asset Management Pty Limited
ASX Code	SEC
Share Price	\$1.935
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	\$116.4m

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 31 January 2023

	1 Month	3 Months	1 Year	3 Years p.a.	Inception p.a ¹
Company ²	7.1%	4.9%	-4.3%	6.5%	6.9%
Benchmark ³	6.6%	7.6%	-4.4%	2.4%	4.7%
Difference	0.5%	-2.7%	0.1%	4.1%	2.2%

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 NTA²

2.262

Post-Tax NTA³

2.264

The NTA values shown above are after the dividend of 2.2 cents per share paid on 6 February 2023. The ex-date of the dividend was 19 January 2023.

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

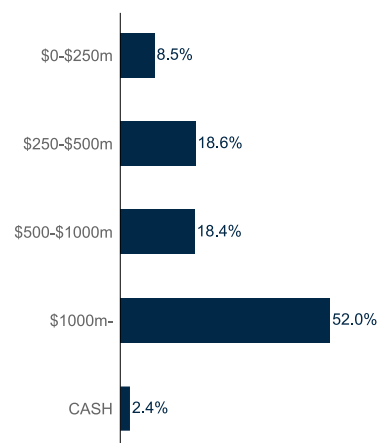
² Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.

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

Top 10 Holdings

Company Name	% Portfolio
Blackmores Limited	4.9
InvoCare Limited	4.7
Flight Centre Travel Group Limited	4.7
IRESS Limited	4.3
Nitro Software Limited	3.9
Insignia Financial Ltd	3.7
Breville Group Limited	3.4
Bega Cheese Limited	3.4
Michael Hill International Limited	3.3
Technology One Limited	3.3
Top 10	39.4

Market Cap Bands



Source: Sphera Asset Management

Markets

The Small Ordinaries and the Mid-Small indices rose 6.6% and 6.3% respectively over January recouping some of the losses felt in calendar year 2022. Whilst smaller companies were most sold off last year (falling almost 18% over 2022 vs. the ASX 100 which was actually up 2.3%), the bounce in markets has so far been uniformly felt across both large and small company indices. Last year saw a confluence of negative events – the re-emergence of inflation, rapid interest rate increases and a war in Ukraine/Russia which caused uneven spikes in commodities and energy. We can only hope that calendar year 2023 is a brighter year for markets and the world in general.

We are often asked by our clients to take out and polish our crystal balls and to prognosticate on the outlook for 2023 and beyond. I only wish our vision was that clear, but if it were we might be making an alternative living dressed in gypsy clothes! The one thing we feel more certain about however is that even if we had perfect macro foresight – and we certainly do not – that would not correlate highly with investment success! The reason is simple. The stockmarket is a forecasting machine itself. It consistently updates share prices based on the average investor's perception of a company's particular future and so much of what people think will happen (at least in next 12-18 months) is sort of baked into the current price. Our job is to assess whether we think the 'baked in' view is more or less likely than the average market participant and to invest accordingly. In other words, if we could predict the macro environment perfectly, we would not be focusing necessarily on the right things as much of the macro may already be factored into share prices. Our fear of a certain thing happening could be well and truly discounted into those share prices already.

The Spheria team spends most of our time looking at business fundamentals and assessing what has been put into share prices and whether we can opportunistically take a different view from the market. Inefficiencies are a small cap investors bread and butter. The other way we "stress test" our portfolio to reduce risks is to start from a conservative base. Our process is built around looking for businesses with cash flow conversion, strong balance sheets (50% of our top 10 holdings are typically net cash balance sheets – meaning they have no debt) and a supportive valuation. We believe this approach is likely to give our investors the best long-term advantage in outperforming the market whilst taking on less risk.

Major Contributors to Performance

Over the month the largest contributors to performance were Blackmores (BKL.ASX, +21.4%), Breville Group (BRG.ASX, +23.2%) and GTN (GTN.ASX, +40.0%).

Blackmores (BKL.ASX) – share price rose 21% in January on no new news. We believe the strong share price performance is a combination of news of China reopening and consumer discretionary names rallying strongly in January. The Chinese market in FY22 made up 22% of BKL's revenue and we expect easing of restrictions will be supportive for growth in that region. We have discussed our thesis for Blackmores in prior commentaries. Their margins continue to remain below that of some of their peers with what we believe is less brand presence. An increase in margins from their current levels to high teens could mean a significant increase of their current earnings. The company has over \$80m of net cash and trades on an EV/EBIT multiple of 20x using a low double digit EBIT margin.

Major Detractors from Performance

The largest detractors over the month were Nitro Software (NTO.ASX, -3.6%), Michael Hill International (MHJ.ASX, -4.5%) and Regis Healthcare (REG.ASX, -7.2%).

Michael Hill International (MHJ.ASX) – share price fell 4.5%, underperforming the broader market despite providing a positive trading update. During the month MHJ released their 1H23 trading update where they revealed sales grew almost 12% with seven fewer stores. Impressively the business has been able to hold margins despite experiencing higher input costs (record diamond prices) and a return of a more promotionally driven retail environment. Consistent with the business philosophy, the company has avoided heavy discounting to hold margins and maintain their strong brand image. As a reminder, MHJ has impressively grown gross margins by 400 bps over the last two years, the balance sheet remains strong with ~\$96m net cash and is trading on ~5x EV/EBIT.

Outlook & Strategy Going Forward

The broader market was due for some kind of “bounce” after the strong selling and general panic of 2022. Whilst January has provided some relief to that selling, there still remains a relative opportunity in small cap stocks which are still well below their level of a year ago. From our bottom-up perspective there remains pockets of strong opportunity in parts of the market. The forthcoming results season is likely to provide some interesting opportunities for portfolio rotation despite a more cautious macroeconomic outlook.

Fund Ratings



Fund Ratings

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

Disclaimer

Spheria Emerging Companies Limited (the Company, ASX: SEC) is a listed investment company (LIC) that provides investors with access to an actively managed, Australian and New Zealand small and micro companies portfolio, designed for investors seeking capital growth and portfolio diversification. It is a confined capacity investment strategy that identifies smaller companies where the present value of cash flows can be reasonably determined and they are assessed to be trading at a discount to their intrinsic value. The smaller companies universe is more volatile and higher risk. An experienced investment manager in the small company end of the market is paramount to success, for this reason there are only a small number of listed investment companies offering access to a diversified small companies investment portfolio. Spheria Asset Management Pty Ltd (the Manager, Spheria), is the appointed investment manager and is a specialist team with a track record of navigating the higher risk opportunities at the small end of the market.

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