Spheria Emerging Companies Limited ASX: SEC

Investment Update 30 September 2024

Overall Commentary

The Company returned 2.6% (after fees) during the month of September, underperforming the S&P-ASX Small Ordinaries Accumulation Index by 2.5%.

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share Price	$2.280
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	$136.3m

[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 30 September 2024

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Company[1]	2.6%	9.6%	22.3%	1.5%	7.9%	7.3%
Benchmark[2]	5.1%	6.5%	18.8%	-0.6%	4.4%	5.1%
Difference	-2.5%	3.1%	3.5%	2.1%	3.5%	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 NTA[2]

2.407

Post-Tax NTA[3]

2.354

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

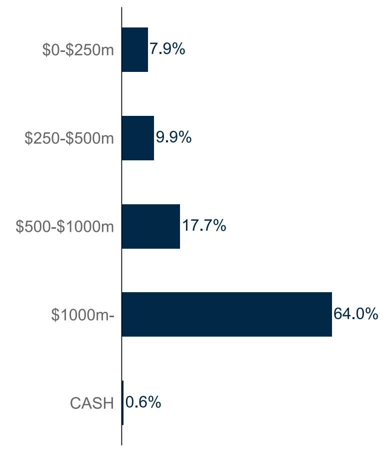
[2] Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.

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

Top 10 Holdings

Company Name	% Portfolio
Supply Network Limited	5.4
Bega Cheese Limited	4.5
Fletcher Building Limited	4.5
Healius Limited	4.3
IRESS Limited	4.2
Sims Limited	3.1
Universal Store Holdings Limited	3.1
Deterra Royalties Limited	3.0
Breville Group Limited	2.9
Technology One Limited	2.9
Top 10	**37.8**

Market Cap Bands



Source: Spheria Asset Management

Markets

The sharemarket's momentum continued through September with the weight of money pushing "growth" type stocks to valuations that appear sublimely ridiculous. Resource stocks also rallied strongly after a very challenging quarter. These two macro factors weighed on performance as we are underweight high multiple stocks and have an underweight position to small cap resources due to a lack of substance (i.e. low costs of production and long duration) outside of the top 100.

Major Contributors to Performance

Over the month the largest contributors to performance were from not owning Light & Wonder (LNW.ASX, -18%) and overweight positions in both NZME (NZM.ASX, +13%) and Sims (SGM.ASX, +15%).

NZME (NZM.ASX) share price rose 13% during the month as the market became more enthused with the outlook for NZ companies post the RBNZ's surprise interest rate cut. NZM continues to deliver on its digital transformation strategy with digital audio revenue and digital subscription (news) revenue growing 33% and 13%, respectively in 1HCY24. The standout was the 63% growth in OneRoof's digital listing revenue and a +70% increase in OneRoof listing upgrades, driving positive earnings for the property portal in what is generally a weaker half for listings. The audience gap between OneRoof and the #1 property platform has reduced to just 10%, with OneRoof continuing to gain share. We believe the market continues to undervalue NZME as an out of favour traditional media company, despite its clear transformation from print to digital (now ~30% of revenue) and the value in owning the outright #2 property portal in NZ which as a market has been slow to transition to digital. NZME trades on only ~4x FY25 EV/EBITA with the outlook for earnings likely to improve from here as the economy recovers and as OneRoof structurally grows.

Major Detractors from Performance

The largest detractors from performance included overweight positions in Star Entertainment Group (SGR.ASX, -34%), Coast Entertainment Holdings (CEH.ASX, -15%) and Fletcher Building (FBU.ASX, -3.6%).

Star Entertainment Group (SGR.ASX) share price fell 34% in September post the company resuming trading post the release of their delayed FY24 results. There are a significant number of moving parts in respect of SGR's earnings outlook including a weak economy, management's ability to execute on cost-out, introduction of carded gaming and the duration of increased remediation costs. Current earnings are heavily depressed due in large part to elevated remediation and compliance costs such that the group is losing money on an EBITDA basis. There does, however, remain significant value in the group's property assets. On our calculations these could be worth anywhere from $700m (24cps) based on value of hotel rooms in isolation up to $2.7bn (94cps) on a replacement cost basis (both after deducting debt and other liabilities). If earnings recover post elevated remediation costs and on a through the cycle basis there is an argument the group could be worth $1bn (or 35cps) or more. Regardless of the potential valuation upside, we have decided to reduce the position size as there remains a high risk of default given expected cash outflows in the short term and uncertainties that surround debt tranche 2 ($100m) which is contingent on $150m of subordinated debt being raised before the end of December 2024, which best case will be highly dilutive at current share price levels. Unfortunately, the investment has been a poor performer, as we significantly underestimated the extent of regulatory risk and the magnitude of early losses at the QWB project.

Outlook & Strategy Going Forward

The market divergence between "have" and "have not" company valuations has continued to stretch. If something does give in the high multiple space, there could be a very healthy rotation to companies that are more attractive from a valuation perspective. The rate cutting cycle which has begun in earnest offshore could be a catalyst for a shift in fortunes for the domestic market which has been driven by the outperformance/valuations of major banks, large caps and perceived high growth stocks.

Fund Ratings

Contact Us

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

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