Spheria Global Microcap Fund

ARSN 627 330 287 | APIR WHT6704AU

Performance as at 31st May 2022

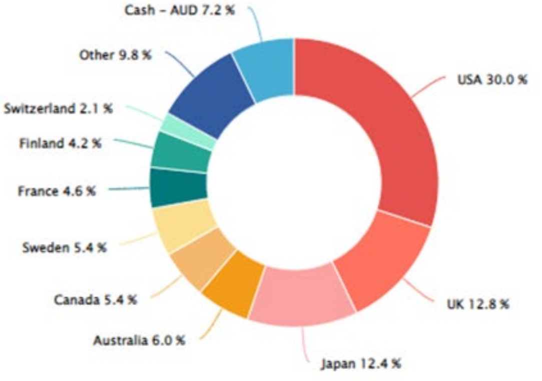
	1 Month	3 Months	1 Year	2 Years p.a.[3]	Inception p.a[3]
Fund[1]	-1.8%	-10.8%	-12.4%	11.6%	12.1%
Benchmark[2]	-2.1%	-6.5%	-12.2%	20.6%	10.6%
Difference	0.2%	-4.3%	-0.3%	-9.0%	1.5%

1 Spheria Global Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes.
2 Benchmark is the MSCI World Microcap Index in AUD (Net) from 1 July 2021 and prior to that MSCI Kokusai (World Ex-Japan) Microcap Index in AUD.
3 Inception date is 1 March 2019. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

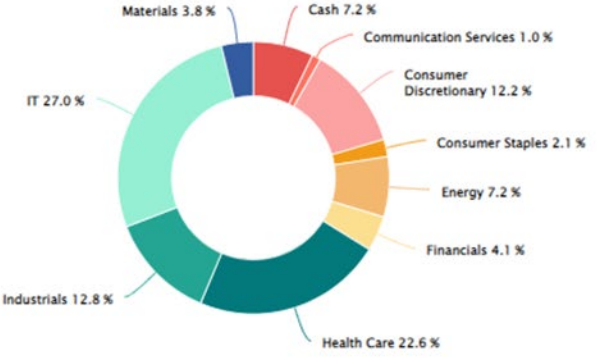
Overall Commentary

The Spheria Global Microcap Fund returned -1.8% (after fees) during the month of May, outperforming the MSCI World Microcap Index by 0.2%.

Regional Exposure



Sector Exposure



Source: Spheria Asset Management

Global Characteristics

	Average Mcap (USD)	EPS Growth (%)	Trailing FCF Yield (%)	Dividend Yield (%)	Net Debt / EBITDA	FCF Conversion (%)
Spheria	635	5.1	5.8	3.8	-0.8	86.8
World Micro	149	-8.3	0.8	3.0	0.9	64.8
World Smalls	1,929	8.3	3.2	2.5	2.1	70.7
S&P500	69,166	16.8	5.0	1.6	0.9	92.7
Nasdaq	5,473	12.0	4.2	0.9	0.3	95.9

Markets

In contrast to the Australian domestic markets, global markets were much more subdued having fallen faster and earlier in the year by comparison. Most of the key drivers of markets so far this year continued to weigh on the indices with interest rates, inflation, and global commodity prices all in focus. The energy sector was a standout last month, rising 8% over the month, followed by Semiconductors and utilities which also increased during the month (all in AUD terms). Biotech, Household and personal care and materials were the worst sectors in the Global Microcap index.

We view balance sheet gearing as something the market will also increasingly start to focus on. Whilst balance sheets have broadly been repaired over the past few years due to capital increases over Covid and the suspension of dividends, those with gearing will start to feel sharply increasing costs of debt. This, coupled with some potential earnings pressure is something investors will need to watch out for. Businesses which have been frequently returning to the market to raise capital to fund “growth” will likely struggle to raise the money needed to shovel into their hungry cash burning furnaces. This is especially so if their share prices have been sold off sharply as the BNPL sector is now finding out. We don’t want to get too pessimistic on the economy and markets however as market rotation and changes in sentiment continually throw up new ideas and we will remain open to attractive investment ideas as sentiment waxes and wanes.

Major Contributors for the Month

Reckon (RKN.ASX) – rallied 47% over May driven by the announcement that they had agreed to sell their Accountants Practice Management business for $100m. To put this in context APS earned roughly 40% of RKN’s EBITDA and the entire EV of RKN prior to the announcement was $100m. RKN expects to distribute most of the proceeds to shareholders via a special dividend. Post the sale the remaining accounting and legal software businesses is still only trading on around a 5x EV/EBIT with no gearing. Not bad for a cash generative SAAS business with growing revenue.

Zynex Inc (ZYXI.NAS) – rose 13% over the month. ZYXI is a leading non-invasive pain management medical hardware provider in the US with strong market shares in its niche. With several of their major competitors having been forced to shut down after they were issued fines, they have a sizeable market niche to pursue in the US. The business is experiencing high top line growth (revenue grew 29% in Q1 this year with expectations at least 20% growth over the full year). The business is running a net cash balance sheet and trading on around 8x our estimates of forward EV/EBIT. Having just completed a relatively modest share buyback they have recently announced a further buyback.

Cresco Ltd (4674.TKS) – rose 14% over the month after reporting very strong results for FY 2022 (Japan operates with a March year end). Revenue was up 12% and EBIT grew 28% which isn’t bad for an IT services business with over US$100m of net cash on the balance sheet and a forward EBIT multiple of around 7x FY 23.

In addition, **Core Labs** and **Computer Modelling** (both oil related services companies) performed well up 7.4% and 5% respectively on an improving environment for energy cycle related companies. This has been our preferred way to play the energy cycle globally as it removes the risk associated with operating smaller oil and gas companies which are typical constituents in the smaller companies arena.

Major Detractors for the Month

Paysign Inc (PAYS.NAS) – declined 30% over the month as the market sentiment for this business waned. We reviewed our thesis on PAYS and have since exited the position reinvesting the proceeds in higher quality businesses we feel offer more sustainable returns over the medium term.

Other detractors over the month included **AB Dynamics** and **Johnson Outdoor (JOUT.NAS)** which were down 26% and 16% respectively. AB Dynamics is a leading automotive testing business based in the UK with net cash balance sheet and a very strong share in the vehicle testing market. JOUT is a leading outdoor consumer technology and equipment maker with brands such as Humminbird (Marine depth sounders), Minn Kota (electric fishing motors) and Jetboil (camping equipment) and ocean kayak. Johnson is a family run business with an immense cash balance on their balance sheet trading on a mid-single digit EV/EBIT.

Outlook & Strategy

Perhaps unsurprisingly we almost view the current market correction as being a healthy cleansing of the approach people take to investing and capital allocation. We believe the global monetary response by Central Banks to Covid over the past few years has most likely been a dramatic over-response to a self-induced slowdown in world economies. In other words, Central Banks used the same medicine to address a slowing of global growth due to Covid as they used for the Global Financial Crisis which was an entirely different set of circumstances. As we come to terms with a real cost of equity (and debt) more rational and longer-term thinking seems to be the lens the markets are now re-examining investments through. Growth at any price is clearly out and cashflows and valuation are front and centre. We anticipate this environment continuing for some time which should favour our fundamental style to markets.

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Platform Availability List

The Spheria Global Microcap Fund is available on the below Platforms. Please check with your platform for minimum investment requirements and fees.

BT Panorama

HUB24

Macquarie Wrap

Netwealth

Praemium

Spheria Global Microcap Fund	
Benchmark	MSCI World Micro Cap Index
Investment Objective	Outperform the MSCI World Micro Cap Index in AUD (Net) over the long term
Investing Universe	Global listed microcap equities predominantly in developed markets with a market capitalisation of US$1.0bn and below at time of purchase
Holdings	Generally 30-80 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
Expected Turnover	20% - 40%
Style	Long only
APIR	WHT6704AU
Minimum Initial Investment	$25,000

Fund Ratings

Zenith APPROVED

Further Information

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

Disclaimer