Spheria Asset Management

Spheria Global Opportunities Fund

ARSN 627 330 287 | APIR WHT6704AU

Performance as at 31 December 2024

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a.[1]
Fund[2]	0.0%	5.1%	13.9%	3.4%	10.8%	12.1%
Benchmark[3]	-1.1%	9.2%	19.2%	6.1%	9.2%	9.7%
Difference	1.1%	-4.0%	-5.3%	-2.7%	1.7%	2.5%

[1]Inception date is 01 March 2019. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.
[2]Spheria Global Opportunities Fund. Returns of the Fund are net of applicable fees, costs, and taxes.
[3]Benchmark is the MSCI World Small Cap Index (net in AUD) for all periods. Please note that the Benchmark from inception to 30 June 2021 was the MSCI Kokusai Microcap Index (net in AUD) and from 1 July 2021 to 30 September 2022 was the MSCI World Microcap Index (net in AUD).

Please note the strategy of the Fund changed effective 1 October 2022. The Spheria Global Opportunities Fund was previously known as the Spheria Global Microcap Fund which targeted global listed microcap companies (companies with a market capitalisation of US$1 billion and below at time of purchase).

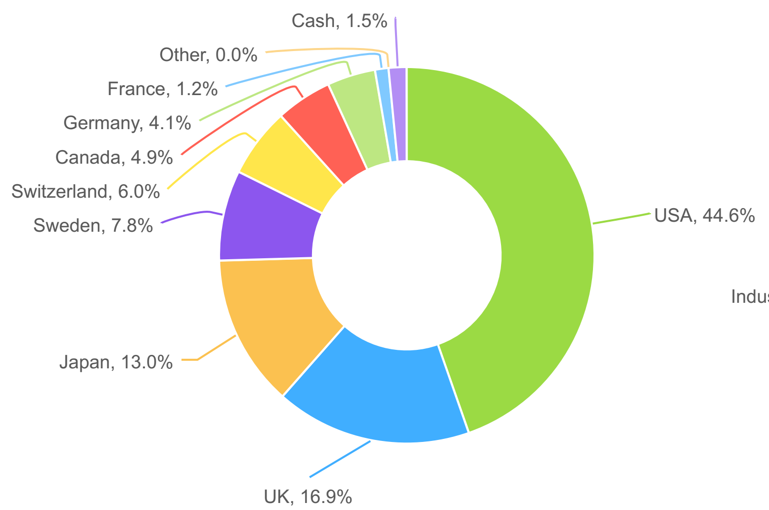
Overall Commentary

In the quarter ended 31 December 2024, the Fund returned 5.1%, underperforming the MSCI World Small Cap Accumulation Index (Net Return) AUD by 4.0%.

Top 5 Holdings

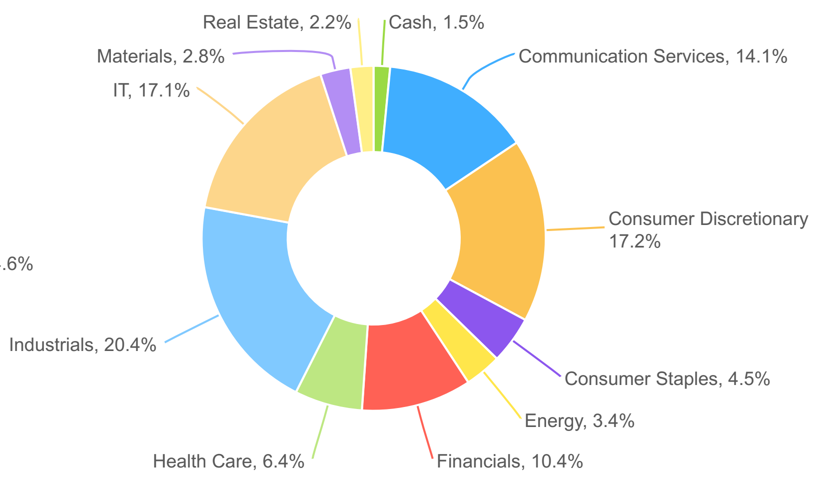
Company Name	% Portfolio
Cargurus Inc	5.0
Accelleron Industries AG	3.9
Wise PLC	3.9
Zuken Inc	3.8
Intertek Group PLC	3.7
Top 5	**20.2**

Regional Exposure



Source: Spheria Asset Management

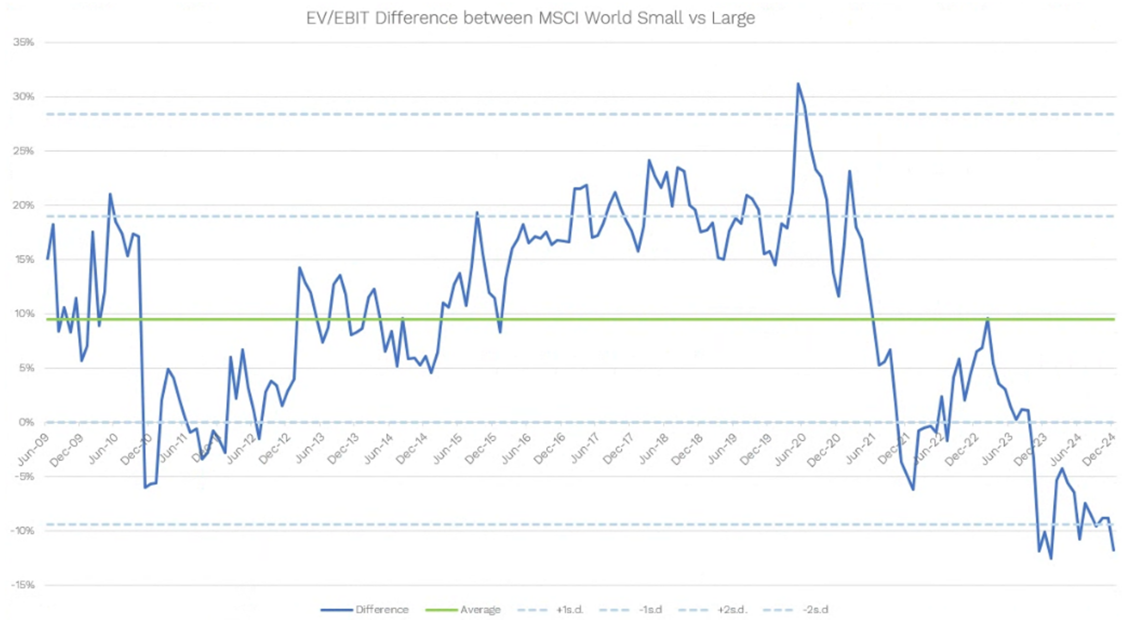
Sector Exposure



Source: Spheria Asset Management

Markets

Small caps underperformed large by 2.8%, undoing most of the prior quarter's outperformance. As with prior episodes of small cap underperformance, this was largely a result of movements in bond yields (up materially over the quarter) coupled with corresponding shifts in risk appetite & liquidity (down). The market continues to be 'schizophrenic' on the issue of inflation, lurching from one extreme to the other in response to the most recent data point. As emphasised previously, we claim little to no insight on such macro drivers, other than to highlight that if history is a guide, the factors driving the underperformance of global small caps to date appear likely to be nearing a turning point.



The dominant driver of the fund's underperformance over the quarter was the +4% outperformance of US stocks, a market in which the fund maintains a material underweight position. Conversely, overweight positions in the UK and Europe dragged on performance, with both regions underperforming the benchmark by –7%. We explore the rationale for this positioning later in the report.

In terms of sector performance, Financials and Information Technology outperformed, whilst Materials, REITs and Healthcare underperformed.

Major Contributors to Performance

Over the quarter the largest contributors were an overweight position in CarGurus (CARG US, +36%), owning LPL Financial (LPLA US, +58%), and owning Wise (WISE LN, +20%).

CarGurus (CARG US) - CARG is a US online automative marketplace that connects buyers and sellers of new and used cars, much in the same fashion as CarSales (CAR AU) operates in the Australian market. Unlike the Australian market, the US is more competitive, with three major players of roughly equivalent size. CARG has been gaining share and trades at an attractive valuation given the potential for this to continue.

The stock returned +36% during the quarter on the back of a strong third quarter result. CARG outperformed market expectations on both revenue and earnings, with pricing the main driver, underpinned by strong adoption of new products that improve dealer efficiency as well as ongoing annual pricing reviews.

CARG is generating top line growth of ~15%pa, well in excess of cost growth, resulting in earnings growth of 50%+. Importantly, CARG is materially outperforming its competitors, with Cars.com reporting a comparatively lackluster result for the quarter.

The Spheria team met in person with CARG management in September 2024 (along with a key competitor) and came away impressed. What stood out was that CARG offers cheaper pricing than competitors, has 20% more inventory and 50% more traffic, all of which translates into a much better ROI for its dealer customers. Further, the company's obsessive focus on innovation was evident, helping dealerships run their businesses better and be more profitable.

CARG is now the largest holding in the fund, reflecting both our conviction in the name and the stock's strong level of outperformance. Trading on a prima facie multiple of 24x FY25 EBIT, CARG doesn't look especially cheap. But excluding the loss-making wholesale business (in which losses are reducing) brings the multiple down to 17x. This is very attractive for a marketplace business that's winning share, generating strong cash flow and has a net cash balance sheet.

LPL Financial (LPLA US) - LPLA is a platform business, not unlike NetWealth (NWL AU), HUB24 (HUB AU) and Insignia Financial (IFL AU) in Australia. It is the largest independent player in the US market, competing with the equivalent arms of the large investment banks (eg. Morgan Stanley) along with smaller regional players. Like NetWealth and Hub24, LPLA generates a substantial amount of its profit from interest earned on client cash balances ('cash sweep').

After being a material detractor from performance in the September quarter, LPL recovered more than all those losses and is now a strong positive contributor to the fund over all time periods.

Prior concerns in the market around cash sweep pricing abated, after the company continued to demonstrate strong client retention and resilient earnings. As a reminder, cash sweep is the practice of automatically transferring excess cash from client brokerage accounts into interest-bearing accounts. Whilst the process is designed to ensure that uninvested cash in client accounts earns a return, it is also true that this is a material source of revenue for LPL and its peers as they earn the ‘spread’ between the rate that can be achieved from investing these funds and what they pay to the end customer.

Concerns over cash sweep pricing have now given way to optimism over how long the company can continue to generate higher-than-normal cash sweep earnings, which the company is typically able to do during periods of higher interest rates. Thus LPL is a beneficiary of inflation and elevated bond yields.

After topping up our holding on weakness in the September quarter, we decided to reduce the fund’s holding into the stock’s strength later in the December quarter.

What hasn’t changed is LPL’s consistent record of strong organic FUA growth and market share gains, highlighting the strength of the group’s value proposition to its core independent advisor customer in a world of growing financial complexity, increasing regulations, and digital transformation. The stock’s valuation remains undemanding on multiples despite its strong recent performance at just 12.5x FY25 EBIT.

Major Detractors from Performance

The largest detractors from performance included owning Sapiens (SPNS US, -20%), owning Intertek Group (ITRK LN, -4%), and an overweight position in Axfood (AXFO SS, -16%).

Sapiens (SPNS US) - SPNS is a global provider of software for the insurance industry. It specialises in helping insurance providers streamline operations and enhance customer experience in much the same way as Technology One (TNE AU) supports local councils and universities with its market leading ERP software.

SPNS declined 20% during the quarter after the company marginally downgraded its full year 2024 guidance and provided first time guidance for 2025 that missed the market’s expectations by ~4%. The softness was attributed to the company’s cloud transition having a greater impact on revenue growth than expected, slower customer decision-making due to a soft macro environment, and competition in the US property & casualty market.

We added to the fund’s holding in SPNS on the share price weakness in the quarter as we believe that the issues above, on balance, are likely to prove transitory.

SPNS is around one quarter of the way through transitioning its client base to the cloud away from an on-premise solution. A cloud-based solution allows the customer to reduce its overheads as it no longer needs to maintain onsite compute and IT support. A better user experience also results from the ability to seamlessly push upgrades from the cloud. For SPNS, there are lower costs, opportunities for incremental revenue generation and a new longer-term contract, meaning more revenue and earnings over time and thus greater predictability.

That final point is worth emphasising as we have witnessed (and profited from) similar disruptions as tech businesses transited to the cloud in the past. The market’s myopic focus on short-term earnings often provides opportunities like these to build positions in high quality companies. At 12x EBIT, a net cash balance sheet, high returns and a strong track record of growth, we believe this is one such opportunity.

Intertek Group (ITRK LN) - ITRK remains one of the top holdings in the fund. As a major player in the testing, inspection and certification (TIC) industry, ITRK is a beneficiary of the seemingly one-way growth in compliance and sustainability standards. Significant barriers to entry in the form of brand and subject matter expertise should ensure that existing participants capture most of that growth. By way of local comparison, ALS Limited (ALQ AU) plays in a similar space, albeit with a greater weighting to the commodities end market.

ITRK underperformed in the quarter despite releasing a positive trading update in late November, reporting solid metrics including 6% organic revenue growth ytd, accelerating to 6.6% over the four months to October underpinned by improving sequential trends across nearly all division. The CEO also noted that the Group is on track to deliver “strong margin" performance and “an excellent free cash flow performance” for the full year to December 2024.

Whilst the stock was only down modestly (-4%) in the quarter, this stands in contrast with the positive operating performance of the business. In our view this is a function of the wider malaise in UK markets, with ITRK suffering in sympathy with weak UK equities and an associated decline in the Pound.

At just 13x EBIT, GDP-plus top line growth, a modestly geared balance sheet and strong returns and free cash flow generation, we very remain optimistic about the potential for ITRK to deliver strong returns for the fund into the future.

Outlook & Strategy

So why is the fund underweight the US market? The first thing to highlight is the unusually high weighting in the benchmark to US names. At 63%, a benchmark-weight allocation to the US market would necessitate that two out of every three stocks we owned be domiciled in that market. Whilst the US economy has a lot going for it, such a significant allocation seems imprudent on the face of it, absent compelling value relative to alternate markets.

So what about relative value? The US market has consistently outperformed most other markets over a number of years. The election of Donald Trump to a second term last November provided the impetus for further outperformance, as the market ascribed more weight to his business-friendly policy positions (lower taxes and reduced regulatory burden) versus those likely to be less friendly for US businesses (higher tariffs and mass deportations). Aside from this apparent cherry-picking by markets, a couple of additional factors that make us cautious about the US are:

1) Stock-based compensation (SBC) is a sensible means of aligning employees with shareholders. But make no mistake, it is a real cost for the business. The issuance of stock merely substitutes what was formerly a cash payment of salary for equity dilution. Under either scenario a cost is borne by equity holders. Like many things in the US, SBC as a concept has been taken to its extremes. The incentive to do so is underpinned by the reporting by companies (and complicit sell-side analysts) of profits on a pre-SBC basis. We know of many companies whose entire reported profit is more than consumed by SBC. This has the effect of obscuring value unless one digs into the accounts to understand discrepancies between 'underlying' and statutory results. It also means that headline multiples are significantly flattered, making the US market appear cheaper than it actually is.

2) Even with this unfair advantage, the US market trades at a material premium, ranging from 40% to 70%, on a one-year forward P/E basis relative to the Japanese, European and UK markets. We are the first to acknowledge the limitations of a PE ratio (which we use here to provide a simple means of comparison) and that expensive assets can always get more expensive. But on the balance of probabilities, we expect some convergence in value across regions over the medium term.

In the meantime, we will continue to turn every stone in our pursuit of the best possible businesses at the best possible price. As always, we will prioritise healthy balance sheets and strong cash generation, as this remains central to our belief in what drives long-term outperformance.

Platform Availability List

The Spheria Global Opportunities Fund is available on the below platforms. Platforms provide investors with consolidated and centralised reporting (including administration, tax, and distribution) by bundling together a range of managed funds as one single product. If the fund is not available on your preferred platform, please contact us. Please check with your platform for minimum investment requirements and fees.

Asgard | HUB24 | Netwealth | Praemium | BT Panorama | Macquarie Wrap

Spheria Global Opportunities Fund	
Benchmark	MSCI World Small Cap Index
Investment Objective	Outperform the MSCI World Small Cap Index in AUD (Net) over the long term
Investing Universe	Global listed small cap and microcap companies with a market capitalisation equal to or lower than the market capitalisation of the largest issuer in the MSCI Global Small Cap Index at the time of purchase
Risk	High
Holdings	Generally 30-80 stocks
Distributions	Annually
Fees	1.10% 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

Spheria Global Opportunities Fund

ARSN 627 330 287 | APIR WHT6704AU

Fund Ratings

Contact Us

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

Disclaimer

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Link to the Product Disclosure Statement
Link to the Target Market Determination
For historic TMD's please contact Pinnacle client service Phone 1300 010 311 or Email service@pinnacleinvestment.com

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