Spheria Global Opportunities Fund

ARSN 627 330 287 | APIR WHT6704AU

Performance as at 30 September 2024

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[1]
Fund[2]	-0.4%	4.3%	15.7%	2.3%	12.2%	11.7%
Benchmark[3]	-0.4%	5.3%	16.2%	3.6%	8.4%	8.4%
Difference	-0.1%	-1.0%	-0.5%	-1.2%	3.8%	3.3%

[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).

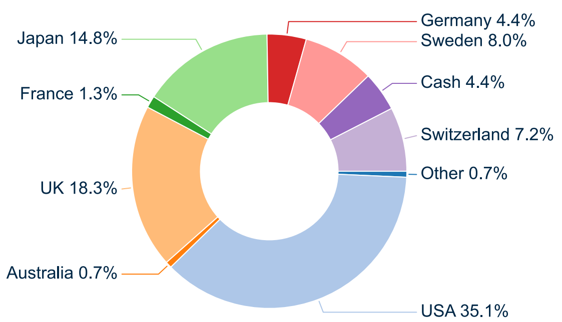
Overall Commentary

The Spheria Global Opportunities Fund returned –0.4% for the month September, underperforming the MSCI World Small Cap index by 0.1% (net of fees). During the quarter to September, the fund returned +4.3% (net of fees), underperforming the benchmark by 1.0%.

Top 5 Holdings

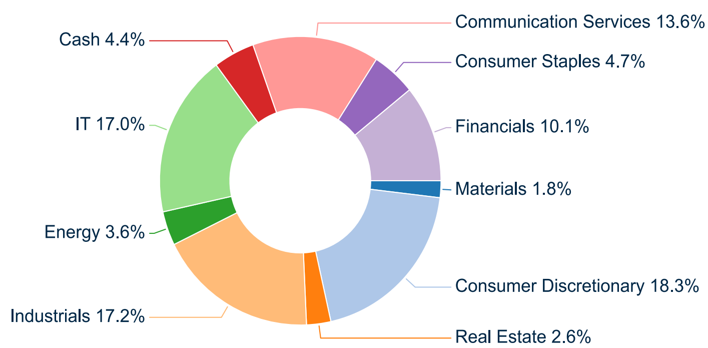
Company Name	% Portfolio
Accelleron Industries AG	4.3
Intertek Group PLC	4.1
Cargurus Inc	3.9
Zuken Inc	3.9
Sapiens International Corp NV	3.7
Top 5	**19.8**

Regional Exposure



Source: Spheria Asset Management

Sector Exposure



Source: Spheria Asset Management

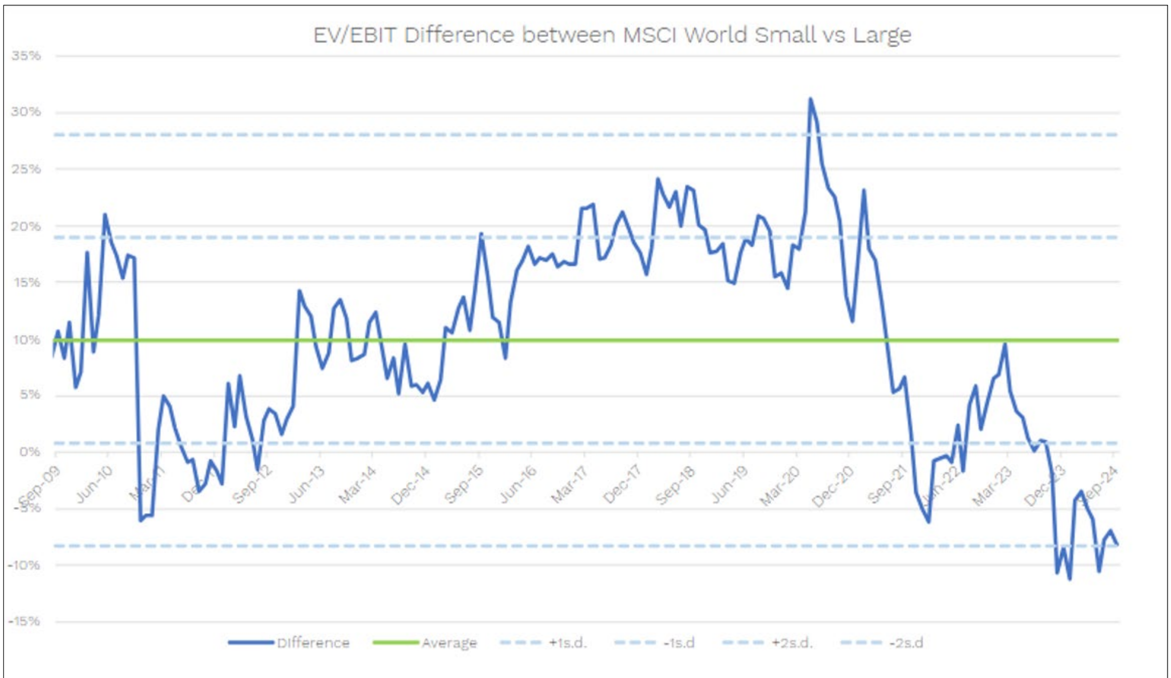
Markets

Pleasingly global small caps outperformed large caps by 3.5% in the quarter, consistent with our expectation that a peak in interest rates was likely to coincide with a turnaround in the relative fortunes of small companies versus large. During the quarter we saw a significant 50bps interest rate cut by the US Fed, alongside cuts from the ECB, Sweden, Canada, and China, as central banks responded to the combination of disinflation and weakening economic data.

Japan bucked the trend with its first interest rate increase since 2016. This triggered a rally in the Yen and a sharp equity market decline as the so-called ‘carry trade’ (long USD denominated investments funded with low rate borrowed Yen) began to unravel. We took the opportunity to top up our Japanese holdings ahead of the subsequent bounce in Japanese small caps off their early August lows. Indeed that market ended the quarter as one of the stronger performing regions in the index. The fund remains modestly overweight Japan, supported by attractive valuations and moves by local regulators to improve Japanese corporate governance practices.

Interest rate sensitive sectors including real estate and financials outperformed over the quarter, whilst information technology underperformed.

Notwithstanding the recent outperformance, the chart below highlights that the relative valuation opportunity in small caps is still very much alive.



Source: Bloomberg, to 30th September 2024.

Major contributors to performance

Over the quarter the largest contributors to performance were from overweight positions in Accelleron (ACLN.SW, +28%), Zillow (Z.US, +33%) and Baltic Classifieds Group (BCG.LN, +30%).

Accelleron (ACLN.SW) - During the quarter, Accelleron reported a strong first half result, with revenue growth of +13% of which half was organic. Turbocharger demand, both in terms of new and the servicing of existing turbochargers, was strong in bulk vessels and power. Management also called out strong growth from datacenters where turbochargers are used in backup diesel generators, although this is still a small part of the group overall. Growth in these areas more than offset slight declines in the US gas compression business and marine low speed (container vessels).

Accelleron was widely expected to be a low growth business at the time of its demerger from ABB in 2021. This has proved to be incorrect as the company has beaten expectations on the back of a combination of market share gains, stronger underlying market growth, and sensible M&A. The company continues to innovate, with its TPX high speed liquid turbocharger for backup power in applications including datacentres, and its automated engine optimisation software (Tekomar XPERT) two such examples.

The company has also made a number of smaller acquisitions that will assist its merchant marine customers in their pursuit of emissions reductions. Last year the group acquired OMT for EUR38m, a manufacturer of fuel injection systems based in Italy. Accelleron can now use its significant market reach to sell both turbochargers and fuel injectors, with growth in the latter underpinned by the expected transition to dual-fuel engines (eg. Diesel and renewable biofuel), which necessitates the need for two fuel injectors. More recently Accelleron acquired OMC2 (4-stroke fuel injection vs OMT 2-stroke) and True North Marine (digital voyage optimisation).

The company now trades on 19x FY25 EBIT, having re-rated from around 10x two years ago. Whilst no longer as cheap as it was, Accelleron is executing well, outperforming ours and the market's expectations as it gains share in turbochargers and broadens its product suite into new and growing TAMs.

Zillow (Z.US) – During the quarter, Zillow reported a solid Q2 result, demonstrating revenue growth ahead of a relatively flat market. Accompanying the result was the announcement that the current COO Jeremy Wacksman would succeed Rich Barton in the role of CEO. We expect little change under Wacksman who has been with the company since 2009.

The outperformance of the stock is largely owing to positive sentiment around US rate cuts. Specifically, Zillow benefits from a greater volume of existing home sales, which currently sit at 4m pa, or ~25% below their normalized level of around 5.5m pa. As interest rates in the US increased from close to zero in 2021 to over 5% in 2023, homeowners were understandably less inclined to move homes as it would have meant relinquishing attractive low fixed rate mortgages. Following the recent rate cut, the market has now turned its attention to the prospect of a rebound in existing home sales from what are historically low per capita levels. Any increase in volume should largely drop through to earnings for Zillow given the operating leverage inherent in its business model.

Zillow also continues to emphasize the opportunity it has from plugging its 'leaky funnel'. Specifically, 25% of buyers seek out an agent through Zillow, yet only 3% of homes ultimately transact through their site. Increased functionality is key to plugging these leaks, with additional product features such as mortgages and touring being introduced progressively across its markets. Taking management's commentary on face value, the results are nothing short of stellar. Mature markets carrying the enhanced feature set are delivering 80% more revenue per total transaction than the markets without them.

We continue to be attracted to Zillow's dominant market position and believe that the combination of a cyclical rebound in existing home sales and growing revenue per total transaction will underpin a meaningful inflexion in the company's earnings profile.

Major detractors from performance

Over the month the largest detractors to performance were from overweight positions in Napco (NSSC.US, -29%), LPL Financial (LPLA.US, -20%) and Computer Modelling Group (CMG.CN, -16%).

Napco (NSSC.US) – The Napco share price was under pressure during the quarter following a slightly soft full year result and the public release of a short report that further spooked the market.

The short report contained an assortment of allegations but little in the way of new or materially relevant information in our view.

The full year result was solid, with revenue +11%, EBITA +77%, strong cash conversion, an increased dividend and a net cash balance sheet of nearly $100m. The negative share price reaction can be attributed to high expectations going into the result along with the slowing rate of revenue growth, which we note was +26% in FY22 and +18% in FY23.

We decided to exit our NSSC position during the quarter, having first started buying it back in 2022 when the stock was $20/share. Whilst the company continues to execute well, at 20x EBIT the stock is not cheap in the context of the slowing rate of revenue growth and medium-term risks around management succession and the potential for misalignment in light of recent share sales by senior executives.

LPL Financial (LPLA.US) – LPLA released its Q2 result in late July which highlighted strong trends with FUA (funds under administration) reaching a record $1.5trn, reflecting +21% total growth and +8% organic growth. Organic growth has averaged 8%pa over the past 4 quarters, highlighting the strength of group's value proposition to independent advisors in a world of growing financial complexity, increasing regulations, and digital transformation. Margins were slightly lower as the group continued to invest heavily in areas such as promotional activity to drive top line growth.

The decline in the share price came as a result of industry activity around cash sweep pricing. 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.

LPL's share price reacted to news that various competitors currently face regulatory scrutiny over the amounts that they are charging for cash sweep. After initially resisting, LPL recently (and sensibly, in our view) elected to reduce its cash sweep pricing. LPL is not the subject of any regulatory action on this front and its recent actions largely remove this risk for the stock.

We took the opportunity to top up our holding during the quarter as the stock looks relatively attractive and its service offering continues to gain traction in the marketplace. LPL is trading on a modest 12x FY25 EBIT, benefiting from strong underlying investment markets and is generating strong cash flow.

Outlook & Strategy Going Forward

Spheria's strategy remains unchanged. We continue to trawl the universe of ~8000 stocks for the very best companies that meet our thresholds for quality, valuation, and financial robustness (cash flow and balance sheet).

After travelling to Japan in June quarter, the Spheria team visited the US in September where we met with 46 companies across multiple industries in four cities over nine days. Management teams were generally cautious on the macroeconomic outlook, with hopes for an interest rate cut (which came the week following our return) balanced against signs of slowing across the wider economy.

The fund continues to be underweight the US reflecting generally stretched valuations following multiple years of outperformance fueled in large part by margin-driven earnings growth. Since returning from the US, we have added to existing positions in Cargurus and Core Laboratories and continue to debate the merits of adding certain new names to the portfolio.

Next month the team is off to Europe where a similarly full schedule is currently taking shape.

The Spheria Global Opportunities Fund owns a diversified portfolio of high-quality businesses that we continue to refine as the team combs through what is an extremely deep and rich universe of opportunities. Versus the benchmark, the fund offers a higher free cash flow yield, owns higher returning businesses, and has materially lower financial leverage. With the backdrop for global small caps improving, the portfolio is well positioned to deliver both strong absolute and relative performance over the medium and longer term.

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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

Fund Ratings

Zenith APPROVED

Investment Grade Lonsec Research

Contact Us

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

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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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