SPHERIA ASSET MANAGEMENT

Spheria Opportunities Fund

ARSN 144 032 431 | APIR WHT0025AU | mFund SPM03

Performance as 31 December 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[1]
Fund[2]	-3.9%	5.6%	-11.2%	6.1%	7.0%	9.1%
Benchmark[3]	-4.2%	7.4%	-12.2%	5.8%	5.8%	8.2%
Difference	0.3%	-1.7%	1.0%	0.3%	1.2%	0.9%

[1] Inception date is 11 July 2016. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.
[2] Spheria Opportunities Fund. Returns of the Fund are net of applicable fees, costs, and taxes.
[3] Benchmark is the S&P/ASX Mid-Small Accumulation Index.

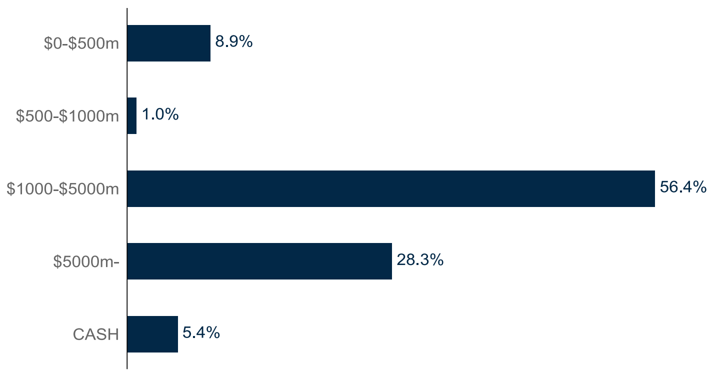
Overall Commentary

The Spheria Opportunities Fund returned -3.9% (after fees) during the month of December, outperforming the S&P/ASX Mid-Small Accumulation Index by 0.3%.

Top 5 Holdings

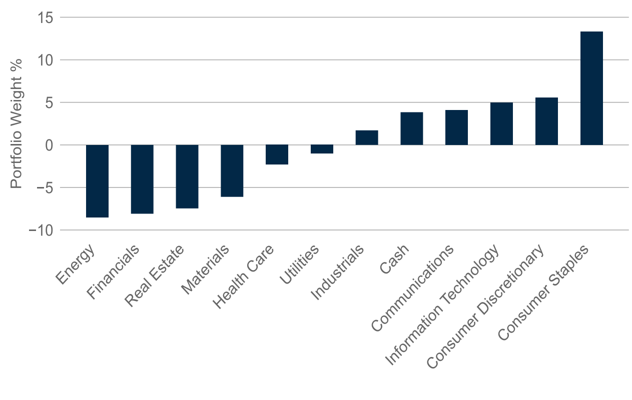
Company Name	% Portfolio
The A2 Milk Company Limited	6.9
Alumina Limited	5.0
Metcash Limited	4.8
ALS Limited	4.4
Incitec Pivot	3.5
Top 5	**24.7**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

The benchmark fell over 4% in December erasing most of the large gain made in November. A perfect storm of negative macro-economic factors continues to pummel asset prices with market participants praying for relief from Central Banks that are fixated with reining in rampant inflation (which they created mind you) by snuffing demand. Monetary policy is a blunt instrument – it will work in time – and we are beginning to see the impacts in the real world with a number of companies in various sectors downgrading profit expectations in the last few months. With a lot of negativity baked into valuations particularly at the "value" end of the market we feel the risk reward scenario is favourably skewed for long term investors, particularly if interest rates have peaked which feels likely given the unprecedented nature of the tightening in terms of speed and overall magnitude of increases relative to high levels of household debt.

Major Contributors to Performance

A2 Milk (A2M.ASX) – rose 11% in December continuing its strong performance from November when it announced it had received FDA approval to supply infant milk formula to the US. We wrote about A2M in previous commentaries and outlined the opportunity in the US could be significant. At the onset the company expects US sales in FY23 to be up to 1m cans, with additional capacity of 9m by June 2023. Whilst the earnings impact for FY23 will be negative due to higher distribution and air freight costs, there could be significant longer-term benefits from scaling its USA operations which have been contributing NZ$20m per annum of operating losses for several years. A2M is utilising their strong balance sheet (+NZ$700m of net cash) to buy back up to NZ$150m of stock and we feel it has a legitimate path to higher margins from a relatively low base.

Bega Cheese (BGA.ASX) – rose almost 11% outperforming the broader market on no news. We have recently discussed some of the headwinds that have been facing Bega including higher farmgate milk prices, elevated competition amongst dairy processors and higher costs arising from weather and COVID-19 absenteeism. In November it was revealed that one of Bega's largest competitors, Saputo would be closing their Australian plants taking approximately 15-20% of capacity out of the market. We view this as good news as there has been too much processing capacity compared to milk supply resulting in companies like Bega having to bid aggressively to secure milk. Despite the recent firming of the share price, we believe the company remains undervalued given the market is capitalising the challenged (bottom of the cycle) environment that Bega currently finds itself. As raw material cost pressures eventually abate, we expect a substantial recovery in the earnings base.

Blackmores (BKL.ASX) – rose 1.7% which outperformed the market in December. Blackmores profit margins remain stubbornly below that of sub-scale peers with inferior brands e.g. Vita Life Sciences (VLS.ASX) which owns Herbs of Gold generates high teen EBIT margins. BKL's scale and brand awareness should see the business generating EBIT margins of at least 20% and possibly up to 40%, in line with larger peers like iNova and Swisse. Taking the midpoint of 30% means a trebling of their current earnings. The company has over $80m of net cash and trades on an EV/EBIT multiple of 18-20x using a low double digit EBIT margin.

Major Detractors from Performance

Star Entertainment Group (SGR.ASX) – fell almost 35% in December after a release from the NSW Treasurer that proposed a significant increase in NSW gaming taxes. The change if legislated or agreed to in full by the casinos would result in an ~$120m pa increase in taxes from 1st July 2023. From a valuation perspective, apportioning an $80m hit to SGR earnings equates to a $1.2bn valuation impact at a 15x EBIT multiple or approximately $1.26 per share. Given the share price has retraced $1.20 from its high in October it appears a near worst-case scenario is being reflected in market pricing. Given the changes will require legislation to be passed by the NSW Parliament which is a complex process it is possible a negotiated outcome between the NSW government and SGR is better than what the market is currently pricing in.

City Chic Collective (CCX.ASX) – continued to fall in December after the company provided another weak trading update with global YTD revenue (as at 18 December 2022) down 7% vs the prior period due to weaker than expected Black Friday/Cyber Monday sales. The weaker retail environment and excess inventory position has forced increased promotional activity which has resulted in further gross margin compression. The company is now expecting a small loss in 1H23. We do not expect this equation to improve in the short to medium term as the company works through elevated inventory. Of greater importance at this point is liquidity and transitioning the balance sheet from a net debt to net cash position which unfortunately is at the expense of group profitability. We are taking a longer-term view on this business and will support the business in the event of a capital call.

Charter Hall Group (CHC.ASX) – fell over 12% in December underperforming the broader market. In accordance with their six monthly process, on the 15th of the month Charter Hall updated the market on the underlying asset values of its property platform according to its independent valuers. The net result was a +0.5% move compared to six months earlier. Notwithstanding this innocuous seeming outcome, it does almost certainly signal the peak for unlisted real estate valuations has been reached and passed, as higher interest rates gradually filter into (lagging) valuer assessments. As a fund manager, Charter Hall is more leveraged than passive real estate owners to changes in rates, which is seeing greater month-to-month volatility in the CHC share price as the market's assessment of future interest rates ebb and flow. We continue to see upside in the company and believe it is well placed to offset valuation headwinds with committed development spend and inflows supported by the company's strong reputation with capital providers.

Outlook & Strategy Going Forward

We are highly constructive on valuations for the companies in our portfolio and for the majority their financial strength, where there is balance sheet risk – for example CCX – we believe the position size appropriate given the range of scenarios. These factors provide us comfort that we are in a strong position to navigate a complex and an extremely challenging economic environment.

Platform Availability List

If a fund is not available on your preferred platform, please contact us. Please check with your platform for minimum investment requirements and fees

FNZ Group

HUB24

mFund

Praemium

Macquarie Wrap

Spheria Opportunities Fund	
Benchmark	S&P/ASX Mid-Small Accumulation Index
Investment Objective	Outperform the S&P/ASX Mid-Small Accumulation Index over the medium to long term
Investing Universe	Primarily listed companies outside the top ASX 50 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Holdings	Generally 20-65 stocks
Distributions	Half-Yearly
Fees	0.99% p.a Management fee & 15% performance fee of the Fund’s excess return versus its benchmark, net of the management fee
Cash	Up to 20% cash, typically 5% - 10%
Expected Turnover	30% - 40%
Style	Long only, risk aware
APIR	WHT0025AU
Minimum Initial Investment	$25,000

Fund Ratings

Zenith RECOMMENDED

Fund Ratings

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

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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