

## Performance as at 31st March 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a. <sup>3</sup>
Fund <sup>1</sup>	2.7%	-0.2%	16.9%	13.7%	13.1%	12.7%
Benchmark <sup>2</sup>	6.2%	-3.4%	13.8%	12.6%	11.3%	11.2%
Difference	-3.5%	3.2%	3.1%	1.1%	1.8%	1.5%

<sup>1</sup> Spheria Opportunities Fund. Returns of the Fund are net of applicable fees, costs and taxes.

<sup>2</sup> Benchmark is the S&P/ASX Mid-Small Accumulation Index.

<sup>3</sup> Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.



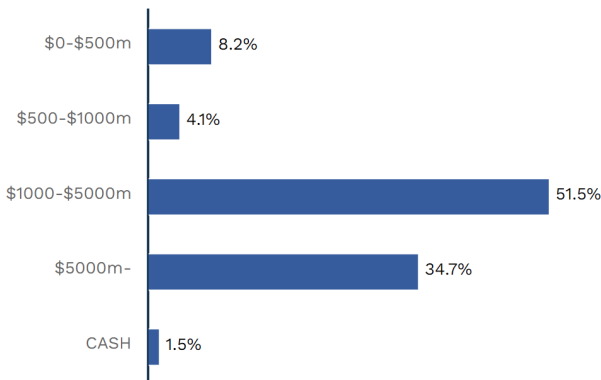
### Overall Commentary

The Spheria Opportunities Fund returned 2.7% (after fees) during the month of March, underperforming the S&P ASX Mid-Small Accumulation Index by 3.5%.

### Top 5 Holdings

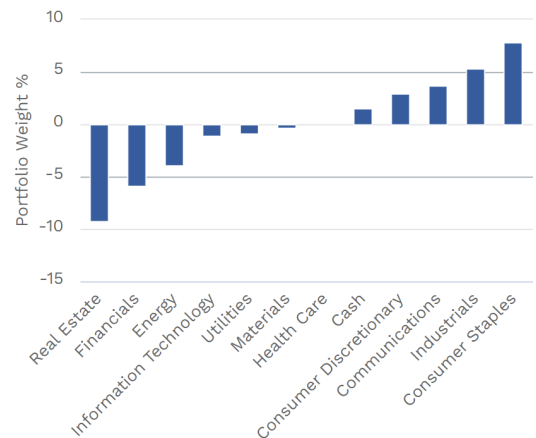
Company Name	% Portfolio
Incitec Pivot Limited	6.6
Alumina Limited	6.0
The A2 Milk Company Limited	5.5
Atlas Arteria	5.0
Orora Limited	4.1
<b>Top 5</b>	<b>27.2</b>

### Market Cap Bands



Source: Spheria Asset Management

### Active Sector Exposure



Source: Spheria Asset Management

## Markets

The local small and midcap indices were both up sharply over March, despite global concerns over the war in Ukraine, rising inflationary pressures and disruptions to the global supply chain. Supply chain issues continue to be exacerbated by the war in Ukraine and the Western sanctions imposed on Russia. Investing in these markets is anything but dull!! Energy prices also continue to rise with other commodity prices – Iron Ore and Lithium also continuing to post gains over the month. Lithium prices in particular are being pushed higher by current demand apparently well exceeding mine supply. We think the current lithium price is unsustainable as, whilst demand is strong, the supply constraints are likely to be relatively temporary. A significant number of lithium miners have announced increases in production to try to take advantage of prices which are three times their peak reached in late 2017.

We typically value businesses on sustainable earnings and are prepared to look through either excessively high or low earnings to help us get a better view of a stock's real value. Sustainable earnings are key though and whilst we have been prepared on occasion to invest in temporarily loss-making business you cannot re-write the laws of economics any more than you can the laws of gravity just because you want to buy an investment story. Sustainable business economics require some anchoring in fundamentals and nothing is more likely to prove this to be the case than a rising interest rate backdrop. As someone wisely once said in order to get the right outcomes you need to measure the right things. The tremendous focus on growth by the market over the past few years has seen the market's focus narrow to areas of marginal economics. *If we can add one more user/viewer/ borrower at slightly less than the cost of acquiring them, this will be value enhancing to investors.* The problem with such narrow focus is that in many cases companies have been chasing revenue growth to the exclusion of all else. There is no point acquiring a customer/ sales lead if the business is unprofitable and servicing your customers takes time, effort and energy. In one previously vaunted segment of the small cap investment universe, the BNPL sector for instance, bad debt write offs are suddenly seeing a sharp increase and competition at the point of sale is seeing marketing costs (read CAC or customer acquisition costs) rise sharply. This is further eroding already marginal economics to begin with. We will continue to scour through some of these fallen angels but with a keen eye to the long term sustainability of the business model.

## Major Contributors for the Month

**IPL (IPL.ASX)** rose 43% over the month, strongly outperforming the market. The company has experience extremely strong tailwinds over the last few months, supported by the strong rally in fertilizer prices. Ammonia prices spiked to a record level of US\$1,625 in March, more than 4x the FY21 average, on the back of structural shortages of the commodity driven by the Ukraine and Russia conflicts. Russia accounts for ~25% of the global export share of ammonia and with many countries imposing sanctions on the country and avoiding accepting goods from the country, this has driven a substantial rally in the ammonia price. This is a positive for IPL, with the lack of supply driving demand at the top line and the higher price of ammonia, driving a substantial uplift in earnings. One of their plants which has been in maintenance is also scheduled to be back online in April, driving potential further upside for the stock.

**Flight Centre (FLT.ASX)** rose 12% over the month as the market started to look ahead to the rebound in travel globally. With Australia decisively re-opening borders and much of the rest of the world embracing travel, we believe FLT is well positioned with a much lower cost of doing business to profit strongly from a rebound in both corporate and consumer travel. FLT's cash burn was significantly reduced during the latter half of their H1 result and continues to trend promisingly over the beginning of H2. Travel in the Northern Hemisphere is rebounding strongly, and we believe there are signs travel may over-recover for a period of time as consumers revenge spend on travel. We believe FLT is trading on sub 10x recovered EV/EBIT at current levels and should enjoy a tremendous earning and cashflow recovery as travel rebounds.

**ALS (ALQ.ASX)** increased 13% in March, after the company announced it had increased NPAT guidance by 6%, compared to the range it provided in November 2021. This was driven by several factors, including strong sample volume growth and price improvements, as it benefits from the capacity increase being delivered during FY22, combined with the additional capacity added through their December acquisition of MinAnalytical.

## Major Detractors for the Month

**Vista Group (VGL.ASX)** fell 15% over the month after delivering FY 21 results, which were slightly disappointing. VGL has gone through a difficult period with its cinema chain customers facing tough times due to COVID related lockdowns and the postponement of cinema content as movie makers have held back content until audiences return. VGL raised capital during the past 18 months and remains net cash. We believe they are well positioned to benefit from re-opening of cinemas and more importantly see a significant upgrade cycle as customers embrace the new Vista Cloud product.

**A2 Milk (A2M.ASX)** shares fell 5% over the month on limited news flow. It reported 1H22 results in February, where the business demonstrated its ability to stabilise and prepare for growth. The business suffered significantly over the last 2 years, on the back of a de-rating as Diagou trade from Australia dried up over COVID travel restrictions and the company had over filled the trade channel with inventory. The business took steps over the first half, to restore inventory to target levels, improve product freshness and market pricing across English label and China label IMF. The business has also taken an active step to increase the reinvestment rate, to further grow and accelerate the brand, after years of underinvestment. A2M has an enviable position in the imported infant formula market in China with a high margin and differentiated product and we believe the company offers good value, trading on <4x EV/Sales and a strong balance sheet (~\$670m of net cash).

**Michael Hill International (MHJ.ASX)** share price fell 6.5% in March, despite a strong 1H result. The company reported half year results towards the end of February, which were strong, with sales growth expanding and margins continuing to improve. Since Daniel Bracken took over as CEO at the end of 2018 the business has gone from strength to strength reporting 11 quarters of consecutive positive same store sales growth since FY19 Q3. Over this time he has continued to improve margins through several key initiatives including growing the brand loyalty program to over 1m members, lowering promotions, enhancing the digital experience to drive digital sales and driving productivity within stores. Trading at around 7 x FY22 EV/EBIT and a net cash balance sheet of over NZ\$80m we feel the business is still materially under-priced.

## Outlook & Strategy

Moves in markets keep things interesting for management teams and investors alike. Our process is based upon trying to be prepared for unforeseeable circumstances, which is why we base our investment decisions on fundamentals like strong balance sheets, good cash flow generation and, importantly, valuation. Valuation has seemingly been a lost art amongst small cap investors over the past 3 years as subnormal interest rates have seen valuations flung to the wind. Popular thematic and disruptive businesses have captured imaginations and – like the sirens in Homer’s Odyssey – drawn unwitting investors in. With a backdrop of global rates on the rise and despite additional risks like the war in Ukraine, our sense is that discount rates and inflation will continue to be the dominant market conditions for some time. Strong businesses with a good ability to mitigate inflationary impacts are likely to do relatively well, assuming valuations are not overly high to begin with. The commodity cycle is in full swing, and we would similarly expect this to benefit our exposure to mining service names. We continue to assess our discount rates based on prevailing market conditions, but it would seem wise for smaller company investors to consider a rate environment at least modestly higher than the prevailing 10-year bond yields imply.

## 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 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



## Further Information

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311 or email [distribution@pinnacleinvestment.com](mailto: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](mailto:service@pinnacleinvestment.com)

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