SPHERIA ASSET MANAGEMENT

Spheria Opportunities Fund

ARSN 144 032 431 | APIR WHT0025AU | mFund SPM03

Performance as at 31st May 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Fund[1]	-5.1%	-4.5%	6.1%	9.9%	12.1%	10.9%
Benchmark[2]	-5.2%	-0.8%	0.5%	9.1%	9.7%	9.6%
Difference	0.0%	-3.6%	5.6%	0.7%	2.4%	1.4%

1 Spheria Opportunities Fund. Returns of the Fund are net of applicable fees, costs and taxes.
2 Benchmark is the S&P/ASX Mid-Small Accumulation Index.
3 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.

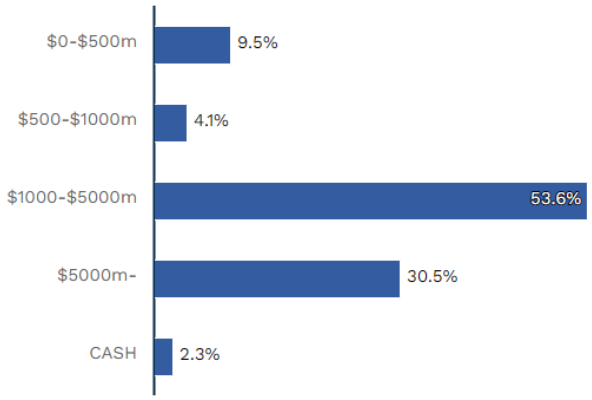
Overall Commentary

The Spheria Opportunities Fund returned –5.1% (after fees) during the month of May, performing inline with the S&P ASX Mid-Small Accumulation Index.

Top 5 Holdings

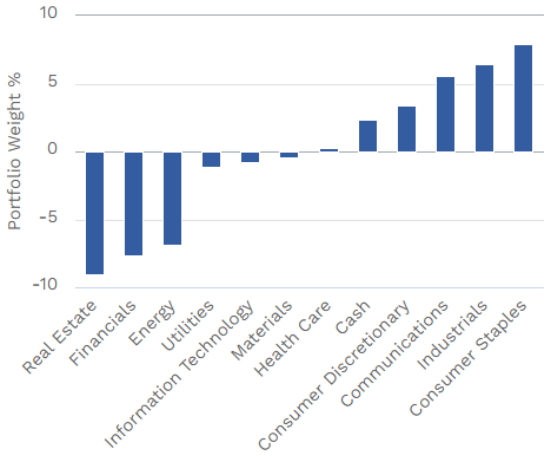
Company Name	% Portfolio
Incitec Pivot Limited	6.6
Atlas Arteria	5.9
The A2 Milk Company Limited	5.5
Alumina Limited	5.5
Orora Limited	4.9
Top 5	**28.4**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

The domestic small and mid-cap indices were off materially over May. 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 in a declining market with healthcare and consumer staples also providing some resilience in the market sell off. Materials and consumer discretionary were the worst performing sectors over the month as investors began to worry about the flow on to consumer demand from the impending rate increases and the cyclicality of building related materials stocks.

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

A2 Milk (A2M.ASX) – rallied 7.6% over May after the company announced it had applied to the US Food and Drug Administration (FDA) to supply infant milk formula. This came after peer Bubs (BUB.ASX) received the health agency's clearance to supply the U.S triggered by the biggest US supplier (Abbot Laboratories) recalling dozens of products after reports of serious bacterial infections in four infants. This would be a significant win for the company given that A2M currently supplies the US with A2 liquid milk. An analogous situation played out previously in China many years ago when an issue with domestic infant formula opened up a significant opportunity for foreign players to gain share. A2M has a strong balance sheet with nearly NZ$700m of cash and is trading at just 2.2x EV/Sales and low double-digit EV/EBIT on a forward basis.

Atlas Arteria (ALX.ASX) – rose 3.3% in May outperforming the broader market on no real news. ALX is a relatively defensive stock with stable cashflows generated largely through European toll roads. In April, ALX reported their Q1 2022 results which saw traffic and toll revenue was up 24% and 22%, respectively on the back of increased travel coming out of COVID restrictions. After suffering through COVID, they are now emerging somewhat as a COVID beneficiary, with people returning to the road to travel.

Monadelphous Group (MND.ASX) – rose 7.6% over May on no major news. Over the prior month MND announced it had secured several new contracts and contract extensions totalling approximately $230m. Whilst this news flow is unlikely to have been a major driver of the shares, the company should be moving closer to seeing a reasonable uplift in their earnings after these had been affected through FY 2021 with COVID lockdowns materially constraining the supply of labour in WA and inflating costs. With a commodity cycle well underway we believe MND is well positioned to pick up material work in FY 23 and FY 24 from both the oil and gas industry and potentially expansions in the lithium industry around the country. Margins which have been under pressure for some time could see a reasonable recovery under this scenario. The balance sheet is well capitalized with $175m of net cash and valuation remains relatively undemanding assuming we see some top-line recovery over the next 2 years.

Major Detractors for the Month

Seven West Media (SWM.ASX) – fell almost 29% in May, despite the company upgrading their FY22 EBITDA guidance. At the beginning of the month, SWM announced EBITDA for the FY22 year will be in the range of $335-$340m, up from $315-$325m, reflecting the strength of the advertising markets and the ongoing success of Seven's broadcast and digital businesses. Whilst a small upgrade, the fall in share price does not seem justifiable, for a business with one of the leading shares in the national television market, and the recent acquisition of Prime Media Group, unlocking additional revenue and cost synergies of the combined regional and metropolitan audience. We believe there is substantial upside from here, with the business trading on ~3x EV/EBITA and solid cash flow conversion.

Vista Group International (VGL.ASX) – VGL declined 18% in May despite announcing a solid trading update at their AGM in late May. Over the past few years VGL has been investing in its core technology to move the business from providing on premise services to a SAAS offering. VGL has just announced its third largest customer has signed onto its Cloud offering validating their model / pricing for cloud services. Typically, they see a material uplift once customers switch to the cloud offering. With a circa 40%+ market share of the global cinema market (ex-China), VGL are by far the strongest player in this niche. With a net cash balance sheet and the likelihood of strong revenue growth due to a material upgrade cycle over the next 2-3 years, coupled with strong margin improvements this business feels well positioned to us. Assuming they can achieve industry comparable margins the business is trading on sub 10x EV/EBIT in 2 year's time for a strongly recurring revenue stream SAAS business.

Mineral Resources (MIN.ASX – not held) – rose 9.1% over the month, on no new news. The business has benefited from the rally in lithium prices and the resilience of iron ore prices. Whilst we like the management team and acknowledge the business has been very successful in growing out the business to incorporate mining and mining services and more recently lithium, it is a name we have refrained from holding. This is because we believe it is being propelled by the unrealistic levels of both lithium and iron ore prices. Both lithium and iron ore prices are trading at well above levels we feel could be considered mid-cycle and the current share price reflects a good deal of optimism that these will continue at current levels for some time. Given their existing two mines are lower grade and higher up on the cost curve this also places the business at more risk as witnessed in 1H22, where the commodities segment was loss making due to the fall in iron ore prices and an escalation of costs.

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.

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

Zenith RECOMMENDED

Further Information

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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