Spheria Opportunities Fund

ARSN 144 032 431 | APIR WHT0025AU | mFund SPM03

Performance as 30 November 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[1]
Fund[2]	3.5%	-1.4%	-5.1%	6.9%	8.5%	10.0%
Benchmark[3]	5.0%	1.7%	-5.8%	7.0%	7.3%	9.1%
Difference	-1.5%	-3.2%	0.7%	-0.1%	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.

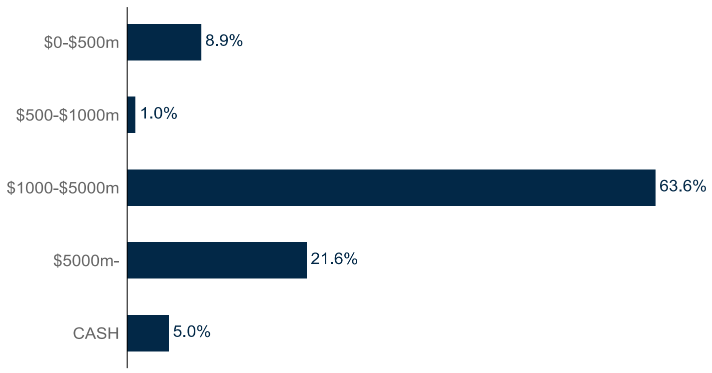
Overall Commentary

The Spheria Opportunities Fund returned 3.5% (after fees) during the month of November, underperforming the S&P/ASX Mid-Small Accumulation Index by 1.5%.

Top 5 Holdings

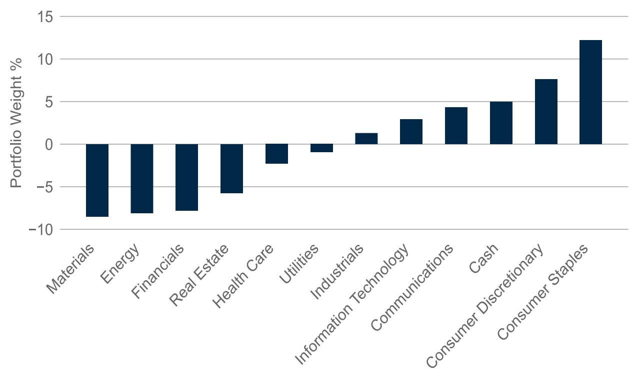
Company Name	% Portfolio
The A2 Milk Company Limited	5.9
Metcash Limited	4.9
Alumina Limited	4.8
The Star Entertainment Group Limited	4.4
ALS Limited	4.1
Top 5	**24.1**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

November was a strong month for share markets globally with both the Small Ordinaries and the Mid-Small Index rallying almost 5% each. Other markets were also up sharply with notable performances from the Eurostoxx up 9.1% and the Hang Seng leading the charge with a 21.5% rebound in A$ terms. The rebound appears to be largely driven by 10-year bond yields falling on the back of generally reducing pressures on inflation. We have been suggesting that there were many forces likely to drive inflation down including falling commodity prices, an unwind of the extreme pressure on goods trade (driven by the Covid surge followed by massive overstocking in the retail system globally) which in turn was driving down shipping and production costs in Asia. This has started to manifest in reported numbers which has got people thinking about when the current rates cycle may peak – possibly sooner and at a lower peak than previously thought.

Our sense is that the real economy will continue to slow in reaction to rate rises and some decisions around energy supply which are now causing system wide price increases. Pressures are being felt along the value chain with companies warning about margin pressures and deferrals in top line spending. In some cases, this is causing outsized reactions in share prices which is offering us opportunities in the small cap space. Whereas we were in a market where people would pay any price to OWN certain stocks, we have shifted to a market in which some people will ACCEPT any price NOT to own certain stocks. This flip in view can create opportunities for longer term and more fundamentally based investors.

Major Contributors to Performance

Positive performance contributions from companies owned included:

A2 Milk (A2M.ASX) – rose almost 18% in November, after the company announced it had received FDA approval to supply infant milk formula to the US. We wrote about A2M in the previous commentary and outlined that 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 $20m per annum of operating losses for several years. A2M is utilising their strong balance sheet (+$700m of net cash) to buy back up to $150m of stock and we feel it has a legitimate path to higher margins from a relatively low base.

Ainsworth Game Technology (AGI.ASX) – rose 58% in November after their 2022 AGM. The business announced they expected 1H23 PBT to be approximately $18m compared to the $10m earned in 1H22 and a significant increase from the losses experienced in FY 21. This was driven by ongoing growth in North America with an increase in the number of machines and sales in new and existing revenues. We wrote about AGI in the prior commentary noting the positive momentum experienced at the full year result as the business emerged from COVID. The company generated $45m of free cash flow (before tax) in FY22 and now sits on +$50m of cash (no debt) and has valuable property in Las Vegas (+$50m). Despite the rally in November, we still feel the business offers value trading on about 7-8x EV/EBIT and returning to growth under a new management team.

Alumina (AWC.ASX) – rose over 12% in November on no new news. The company provided a trading update in October, where they reiterated the cost pressures facing the business from higher gas and soda prices. In response to the higher energy prices in Europe the business has decided to reduce production at the San Ciprian (Spain) refinery to approximately 50% capacity. It also plans to improve performance at the WA refineries to improve volumes and address maintenance issues. Despite some of the headwinds facing the business, AWAC remains a first quartile producer globally with a long reserve life, almost no gearing and pays out a large proportion of its earnings as dividends. On our mid cycle earnings AWC trades on less than 10x ev/ebit.

Major Detractors from Performance

City Chic (CCX.ASX) – share price fell 39% in November after the company delivered a weaker than expected trading update at its 2022 AGM. The company's share price has been under pressure since its financial year result in August after the company revealed weaker gross margins and balance sheet moving from net cash in FY21 to modest net debt. Management had, like many other retailers, made the decision to increase inventory to ensure there was sufficient stock to meet demand. As demand waned from high levels however, CCX has been caught with significantly higher stock levels than it would usually have. We believe the share price fall has created an opportunity to buy a business at a significant discount to our view of its intrinsic value. The core driver of their earnings continues to be their Australian City Chic store business. Given the share price weakness you are buying the Australian business for ~5x normalised EBIT with potentially more upside for profit turnarounds at its international online businesses – Avenue (US based) and Evans (UK based).

Star Entertainment Group (SGR.ASX) – fell almost 8% during November after the Queensland Attorney-General issued show cause notices in relation to money laundering and criminal associations arising from an independent external review into the operations of The Star's casinos in Queensland. In October, after a similar process the NSW Casino Regulator fined SGR $100m and appointed a manager to oversee the Sydney casino. Since the end of last month, the Queensland State Gaming Regulator has announced a similar penalty and sanctions against SGR. The negative headlines have weighed on the share price for most of this calendar year, but with all regulatory actions now in the past and the licenses retained we feel there is significant valuation appeal at current levels. In the past, SGR has generated strong economic returns on tangible capital (mid-teens). Given the business is trading at a small premium to NTA, we feel there is genuine upside as returns mean revert particularly after completion of Queen's Wharf Brisbane (QWB) which is expected to open in the 2H of CY2023.

EVT (previously Event Hospitality and Entertainment) (EVT.ASX) – share price fell over 7% in November after the company delivered its 2022 Strategy Day. We don't believe the investor day revealed any negative news, the share price reaction appears to be somewhat of a moderation of the strength of its share price in October. As discussed in last month commentary the business appears to have recovered strongly from COVID, with Thredbo revenue ~28% ahead of pre-COVID levels, cinema revenue strong and hotel occupancies improving in Q1 2023. The business revealed it will remain disciplined around its property divestment strategy with the pace of sales slowing given the property backdrop.

Outlook & Strategy Going Forward

The move in markets over the past few months reflects a fairly dramatic shift in sentiment around mid-term interest rates. Whilst we are broadly of the view that inflation will be tamed, we harbour some concerns over the short to medium term around the real economy. Companies are laying off staff, energy costs are rising and interest rates are starting to bite. Against this, investor skittishness is providing sporadic and to us, highly attractive, investment opportunities which suits our style of investing. Lastly, Private Equity firms are clearly on the hustings having raised substantial sums of money (for which they earn no fees until said capital is deployed). As rates find a level and if opportunities continue to present themselves our sense is that several of our cash generative and reasonable to lowly geared companies may find themselves in the crosshairs of these investors.

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

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Fund Ratings

Fund Ratings

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

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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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