Spheria Opportunities Fund

ARSN 144 032 431 | APIR WHT0025AU | mFund SPM03

Performance as 31 October 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[1]
Fund[2]	6.3%	-1.7%	-8.8%	7.0%	8.5%	9.5%
Benchmark[3]	6.8%	-0.7%	-9.8%	6.3%	7.0%	8.3%
Difference	-0.5%	-1.0%	1.0%	0.7%	1.5%	1.2%

[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.

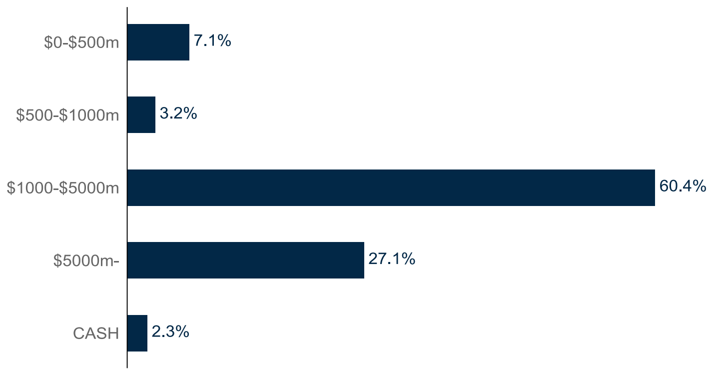
Overall Commentary

The Spheria Opportunities Fund returned 6.3% (after fees) during the month of October, slightly underperforming the S&P/ASX Mid-Small Accumulation Index by 0.5%.

Top 5 Holdings

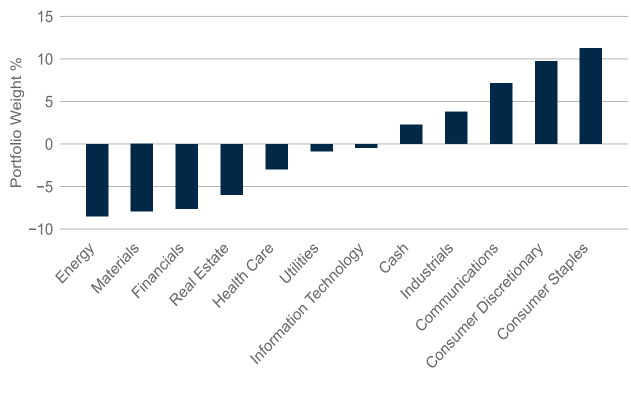
Company Name	% Portfolio
Metcash Limited	5.8
The A2 Milk Company Limited	5.5
ALS Limited	5.3
REA Group Ltd	5.1
Alumina Limited	4.9
Top 5	**26.5**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

Sharemarkets rebounded strongly in October, we managed to keep up for the most part. Interestingly, at the smaller end of the market there was heightened level of M&A in the downtrodden technology sector. This was kickstarted by the private equity led acquisition of Nearmap (NEA) in mid-August – at a significant premium – followed recently by a spate of public to private proposals for Nitro Software (NTO), Tyro Payments (TYR), Elmo software (ELO), and Readytech (RDY). Interestingly, premiums offered seem unusually generous given the macro backdrop with ELO for example being a 100% premium to the undisturbed share price. It may indicate there is healthy appetite (i.e. multiple parties) hunting for acquisitions in the technology space and perhaps weakness in the Australian dollar is providing greater firepower for acquirers who are mostly USA based. Whether this takeover activity permeates more broadly (outside of the tech sector) will likely be a function of the cost and availability of debt, albeit many corporates are sitting on healthy balance sheets providing flex for M&A and have an imperative to get bigger with organic growth moderating due to weakening macro conditions. Strategic growth may therefore be on the agenda particularly for multinationals with majority US dollar denominated earnings.

Major Contributors to Performance

Positive performance contributions from companies owned included:

Flight Centre (FLT.ASX) – after falling in September FLT rallied 17% in October on no company specific news. Many travel related companies including Qantas, Auckland Airport and Air Canada - to name a few - reported stronger than expected results during October with demand for travel continuing its rebound. This is supportive for FLT and echoes the company's recent result with the Leisure division transaction values returning to 70% of pre-COVID levels and the Corporate division now above pre-COVID levels. The business has emerged from COVID period with a leaner cost structure particularly in its Leisure division and is trading on only ~10x recovered EV/EBIT. Share price recoveries out of previous sharp downturns including World Trade Center (2001) and the GFC (2008) were pronounced and multi-year in nature, we suspect history will repeat despite a potentially weaker macro-economic backdrop.

Dominos (DMP.ASX) – rallied almost 24% in October, as the market rotated to out of favour "growth" names. From a fundamental perspective, DMP has been under pressure as the market has shifted away from food delivery, impacting demand while input costs are rising significantly. This equation means it's difficult to raise prices and has led to margin pressure for franchisees which has a run-on impact on the profitability of DMP the franchisor (although it owns corporate stores as well). As a result, earnings at DMP have been rebased substantially in the last 12 months but with the sharp share price retracement there is now a valuation argument for owning a satellite position in the portfolio. Our reticence to increase the position size reflects the balance sheet, which has weakened considerably in recent years due to weak cash flows, acquisitions and relatively high dividend payments.

ALS (ALQ.ASX) – rose 13% in October again as the market rotated to "growthier" companies. In support of ALQ it is not that expensive at 14x EV/EBIT, and it has delivered strong earnings growth since FY17 albeit it is exposed to cyclical end markets particularly the minerals testing side of the business where the gold sector has been a swing factor in the past. To the company's credit, management have executed well and have reduced this reliance by building out the life sciences and industrial testing divisions.

Major Detractors from Performance

The main detractors to performance were from companies that we did not own during period with the largest three being mining companies:

A2 Milk (A2M.ASX) – fell just over 2% in October in strong market. A2M has bounced back from its lows after a strong sales and earnings update in September. We feel the business is well placed to continue its recovery as it expands its store reach in China and continues to invest more into marketing to sustain and grow its market share in China. The company was recently approved by the FDA to sell infant formula to the USA market for the first time. This could spell significant upside in the long term as the company can now scale its USA operations that have been contributing +$20m per annum of operating losses for several years. A2M is sitting on a healthy balance sheet with +$700m of net cash and we feel it has a legitimate path to higher margins from a relatively low base.

Adbri (ABC.ASX) – fell 14% in October after the company provided an abysmal trading update and announced the CEO would be leaving the business. Net profit after tax (underlying) in CY23 is now expected to be between $75-85m, about one-third less than expected. This fall a continuation of the last four years' experience with earnings in a significant downtrend since CY18 and having more than halved since then. Interestingly, the company is now generating a ROIC of less than 6% on a historic cost basis. Whilst there are industry wide issues plaguing returns, we feel mismanagement has also played a major role, this situation is therefore salvageable in the appropriate hands and at worse there is enormous value in the property assets underpinning the business with the Kwinana Upgrade project, for example, to free up a significant land bank in Munster that could be worth +$300m (2027-2031) after rezoning and development. In the short to medium, Moorebank is expected to bring in ~$50m and Badgerys +$100m, respectively. Whilst the balance sheet is stretched due to capital expenditures (primarily Kwinana) and lower earnings, we feel there is enough buffer in debt covenants and assets sales to ride out this challenging period.

Reliance Worldwide (RWC.ASX) – fell over 5% in October, after the company reported a disappointing Q123 update. Sales grew 23% vs pcp, and 6% excluding EZ-Flo, a business acquired in November 2021. This was driven by an ~8% increase in prices, with volumes weak in the US, EU and UK. Despite increased prices, lower volumes and higher costs drove margins lower. Specifically, higher input costs for raw materials such as copper, zinc and stainless steel purchased early in 2022. We feel these pressures are short term in nature, with commodity prices already easing from their 2021 record highs. Whilst we are cognisant that the business is partially linked to the building cycle, which is now on a downward trend, the key products tend to be sold predominately for remodel and repair works as opposed to new builds and hence should shield it partially from the full building cycle downturn. RWC is the lead manufacturer in brass Push-to-Connect (PTC) plumbing fittings and a global leader in the manufacturing and distribution of plastic PTC fittings and accessories.

Outlook & Strategy Going Forward

Despite all the negativity, the Australian economy is actually travelling well with strong employment underpinning consumer demand and strength in commodity prices driving capital investment. It is possible bureaucrats in Australia engineer a softer landing than the market is currently suggesting, albeit offshore events may upset that equation. Our meetings with companies suggest that inflationary pressures are abating somewhat. The outlook for interest rate rises may therefore be tempered, which is a key driver of sharemarkets. We think these are reasons to be constructive on the investment outlook particularly given depressed valuations across our portfolio that are imputing a deep recession in many circumstances.

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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