Spheria Emerging Companies Limited (ASX:SEC)

Investment Update 28 February 2022

Overall Commentary

The Company performance for the month of February was 1.8%, which outperformed the S&P / ASX Small Ordinaries Accumulation Index by 1.8%.

Company Facts

Investment Manager	Spheria Asset Mangement Pty Limited
ASX Code	SEC
Share Price	$2.32
Inception Date	30 November 2017
Listing Date	5 December 2017
Benchmark	S&P / ASX Small Ordinaries Accumulation Index
Dividends Paid	Quarterly
Management Fee	1.00% (plus GST) per annum[1]
Performance Fee	20% (plus GST) of the Portfolio's outperformance[2]
Market Capitalisation	$139.5m

1 Calculated daily and paid at the end of each month in arrears.
2 Against the Benchmark over each 6-month period subject to a high-water mark mechanism.

Performance as at 28th February 2022

	1 Month	6 Months	1 Year	3 Years p.a.	Inception p.a[3]
Company[1]	1.8%	-4.1%	12.8%	11.8%	10.0%
Benchmark[2]	0.0%	-9.1%	5.0%	7.7%	6.9%
Difference	1.8%	5.0%	7.8%	4.1%	3.1%

1 Calculated as the Company's investment portfolio performance after fees excluding tax on realised and unrealised gains/losses and other earnings, and after company expenses.
2 Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.
3 Inception date is 30th November 2017. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

Markets

The local small and midcap indices were broadly flat over February, despite the index increasing early in the month before falling mid-month due to conflict in the Ukraine. Countries reacted by imposing sanctions on many of Russia's key exports, with the intention of causing significant financial distress to the country. As a result, commodity prices, particularly oil rallied strongly over the back half of the month and continued into March, as markets feared the sanctions imposed would impact global supply of crude oil, for which Russia is second largest producer in the world. In March, oil surpassed US$120 per barrel, topping a 14-year record, last seen in 2008 prior to the GFC. This coupled with the already strong inflationary numbers, is providing further fuel to the inflationary outlook. Despite the potential near term hesitation from Central banks to raise interest rates, as they evaluate the short-term implications of the Ukraine situation, we expect rates will rise and rise considerably to curb inflationary pressures. This was reaffirmed in the February reporting season; with many companies reiterating the rising cost pressures many businesses are experiencing due to strong demand and supply side constraints.

Net Tangible Assets (NTA)[1]

Pre-Tax NTA[2]

$2.510

Post-Tax NTA[3]

$2.440

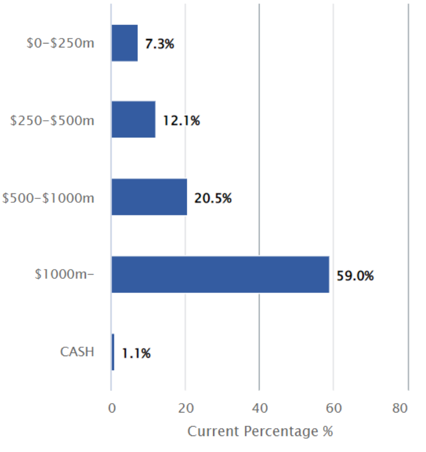
1 NTA calculations exclude Deferred Tax Assets relating to capitalised issue cost related balances and income tax losses.
2 Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.
3 Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings.

Top 10 Holdings

Company Name	% Portfolio
InvoCare Limited	5.4%
Flight Centre Travel Group Limited	4.9%
Blackmores Limited	4.6%
Michael Hill International Limited	4.4%
Monadelphous Group Limited	4.1%
HUB24 Limited	3.9%
Adbri Limited	3.6%
IRESS Limited	3.6%
Seven West Media Limited	3.6%
Ht&E Limited	3.3%
Top 10	**41.4%**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Major Contributors for the Month

Monadelphous (MND.ASX) rallied 26% over February. MND reported its 1H22 results in February which beat expectations, with the Company's Maintenance and Industrial Services division achieving a record half of sales. Overall profitability rebounded strongly after being heavily affected by government restrictions that constrained the supply of labour in the WA market. With restrictions now being eased, we believe the worst of it is behind them. In addition, the business has strong industry tailwinds, with elevated levels of demand for its core services due to buoyant commodity prices. We continue to like the business as MND has one of the best sector performance histories – executional excellence, consistent cash flow and a conservative management team. The business currently has a net cash balance sheet ($175m net cash) and is trading on an EV/EBIT of around 10 x FY23.

Invocare (IVC.ASX) rose 16% over the month, strongly outperforming the market. The company reported its full year 2021 result in February, which rebounded strongly after being affected in CY20 by government restrictions. IVC operates funeral and memorial services across Australia, New Zealand, and Singapore. The company is most of its way through a significant refurbishment program that will enable it to sustain or even increase market share. Counterintuitively, excess deaths in Australia have trended negatively for the last two years despite a pandemic. Unfortunately, we believe a return to normal levels will benefit industry participants including IVC. Trends in excess death rates overseas lend support to this thesis.

Adbri (ABC.ASX) outperformed over the month, after reporting its CY21 result, that beat expectations. The business grew revenue 8% driven by improved demand across residential, infrastructure and commercial sectors. The group's lime volumes were better than expected, buoyed by demand from alumina, gold and nickel producers. The company also announced in January that it has extended its supply of quicklime to Alcoa until 2023, we view this as a significant structural positive. In addition, the company continues to be a large land holder, which they will continue to monetise over time.

Major Detractors for the Month

Nitro (NTO.ASX) declined 21% in February like many other technology related names. What has attracted us to NTO are the market share gains they are making against industry leader Adobe who continues to cede share to Nitro Pro. Nitro has expanded its product suite from document productivity software (like Adobe Acrobat) into e-signing, which we see as a potentially large industry. NTO has recently strengthened their position in e-signing with the acquisition of European based Connective. With a high client retention rate (over 95%) and a business model which has transitioned from on-premise to a SAAS model, we believe the business will prove to be a successful investment despite the pull back in the share price. NTO's balance sheet is well funded with over $60m of net cash.

City Chic Collective (CCX.ASX) detracted from performance as the share price declined 20%, after the company announced its 1H22 result. After being a significant COVID beneficiary, like several other retailers over 2021, the market reacted poorly to its first half 2022 results, as the company announced increased costs and a significant increase in inventory which in the near term will impact cash flow conversion and their cash position. The higher costs and increased inventory are part cyclical but also reflect the growing geographic breadth of the business and channels to market. The long-term story remains intact; however, we expect margins and therefore profitability to be lower than expected to fund the robust growth profile.

Sims Limited (SGM.ASX – Not Owned) surged 28% over February, as the company delivered earnings well above expectations, driven by strong macro-economic conditions, in particular plentiful scrap supply and steel demand and rising commodity prices in particular copper. We exited our position in SGM last year after a significant rally in the share price, it has now rebounded back to and above those levels. We continue to believe it is solid business, however, the cyclical nature of the industry warrants some caution if extrapolating current margins and profitability.

Outlook & Strategy

The market has entered a period of uncertainty with the prospect of rising interest rates and a conflict in Ukraine which is exacerbating many of the concerns around inflation and commodity price pressures. Despite the volatility we believe our focus on valuations and sound balance sheets is likely to continue to see the portfolio perform well over the medium term. With the pullback in markets over recent times, valuations are becoming more appealing in many names that were previously fully valued.

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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