

Overall Commentary

The Company performance for the month of May was -6.3%, which outperformed the S&P / ASX Small Ordinaries Accumulation Index by 0.7%.

On 6 May 2022, the Company paid a fully franked quarterly dividend for the period ended 31 March 2022 of 2.5 cents per share to SEC shareholders.

The Company is pleased to announce the dividend reinvestment plan (DRP) is now available to shareholders.

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share Price	\$2.11
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	\$126.9m

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 31st May 2022

	1 Month	6 Months	1 Year	3 Years p.a.	Inception p.a. ³
Company ¹	-6.3%	-10.6%	0.2%	8.1%	7.9%
Benchmark ²	-7.0%	-11.0%	-4.6%	5.5%	5.7%
Difference	0.7%	0.5%	4.8%	2.6%	2.3%

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 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 cyclical of building related materials stocks.

Net Tangible Assets (NTA)¹

Pre-Tax NTA²

\$2.327

Post-Tax NTA³

\$2.319

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.

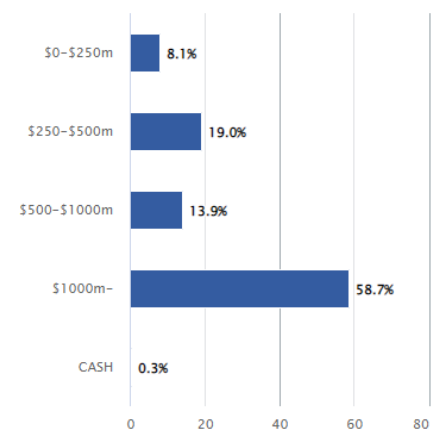
³ Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings.

Top 10 Holdings

Company Name	% Portfolio
Blackmores Limited	5.6%
Flight Centre Travel Group Limited	5.0%
InvoCare Limited	5.0%
Monadelphous Group Limited	4.4%
IRESS Limited	4.2%
Michael Hill International Limited	3.7%
Bega Cheese Limited	3.4%
Adbri Limited	3.4%
INSIGNIA FINANCIAL LTD.	3.3%
Event Hospitality and Entertainment Ltd	3.1%
Top 10	41.1%

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

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

Reckon (RKN.ASX) – rallied 47% over May driven by the announcement that they had agreed to sell their Accountants Practice Management business for \$100m. To put this in context APS earned roughly 40% of RKN's EBITDA and the entire EV of RKN prior to the announcement was \$100m. RKN expects to distribute most of the proceeds to shareholders via a special dividend. Post the sale the remaining accounting and legal software businesses is still only trading on around a 5x EV/EBIT with no gearing. Not bad for a cash generative SAAS business with growing revenue.

Horizon Oil (HZN.ASX) – rose over 15% on the month after the company announced upgraded guidance largely due to sustained higher oil prices. The company has benefited in recent months from the record high oil prices due to constrained supply on the back of sanctions imposed on Russia and a global under investment in oil production. Late in the month the company announced an upgrade to guidance with revenue increasing to US\$105-\$110m up from \$90-\$100m. At current crude oil prices, the company is generating US\$40-48m of free-cash-flow per annum and with a market-cap of US\$150m and net-cash of US\$27.5m is trading on ~2-2.5x EV/free cash flow. We believe HZN remains a relatively attractive way to gain exposure to the energy cycle with a net cash balance sheet.

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) – declined almost 29% in May despite the company upgrading their FY22 EBITDA guidance at the beginning of the month. SWM announced that EBITDA for the FY22 year would 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 relatively modest upgrade the fall in share price seems to reflect a change in sentiment towards consumer discretionary stocks and the outlook for advertising spend more generally. Despite the outlook for media (and many other sectors possibly dimming) SWM is amortising its debt very quickly with strong cash flows. The valuation for the business with rapidly digitising revenues seems highly attractive at ~3x EV/EBITA.

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.

Whitehaven Coal (WHC.ASX – not owned) – rose 7% over the month as coal prices globally remained elevated on the back of energy demand and the many supply disruptions taking place globally. WHC has decent mine lives and is generating incredible levels of cash currently such that the balance sheet has been substantially de-gearred. On spot prices (which are a long way above mid cycle levels) WHC is trading on very low earnings and EBIT multiple. The debate is centred largely around how long current prices can be sustained and what imposts over time will be levied on heavy carbon producers and emitters.

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.

Fund Ratings



Further Information

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311 or email distribution@pinnacleinvestment.com

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