

Overall Commentary

The company performance for the month of November was -1.3%, while the S&P/ASX Small Ordinaries Accumulation Index returned -0.3%.

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share Price	\$2.58
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	\$155.2m

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 30th November 2021

	1 Month	6 Months	1 Year	3 Years p.a.	Inception p.a. ³
Company ¹	-1.3%	12.0%	30.0%	15.9%	12.0%
Benchmark ²	-0.3%	7.3%	18.4%	13.5%	9.5%
Difference	-1.0%	4.8%	11.6%	2.4%	2.5%

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 cap index declined modestly over the month, with mid cap indices up slightly over the month, as mid cap names outperformed smaller companies. The trends broadly followed those of recent months with many new age battery materials names continuing to rally on the fervour related to battery demand. Gold equities also performed well over the month recovering some of their lost ground year to date.

Several AGM statements released over November however, reminded investors of the importance of meeting expectations – especially if those expectations are high. Several names in the small cap space had significant declines on weaker than expected updates with Tyro Payments (TYR.ASX, -29%), Nearmap (NEA.ASX, -28%), Nuix Ltd (NXL.ASX, -27%), Betmakers (BET.ASX, -26%), Clinuvel Pharm (CUV.ASX, -25%) and Sezzle (SZL.ASX, -24%) falling significantly. The market appears to be finally tiring of cash burning companies promising strong future earnings typically in disruptive industries. Whilst we are fans of smaller company innovation, we also believe that businesses with unproven business models tend to disrupt their investors wealth more than the markets in which they operate.

Net Tangible Assets (NTA)¹

Pre-Tax NTA ²	\$2.669
Post-Tax NTA ³	\$2.557

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.

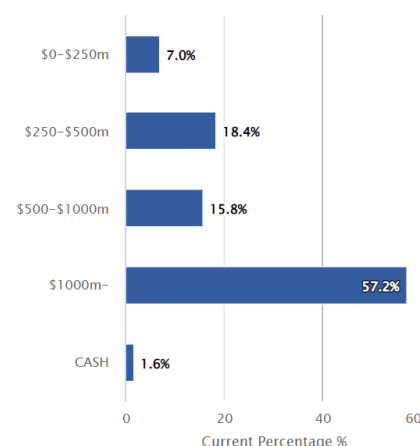
³ Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings.

Top 10 Holdings

Company Name	% Portfolio
Flight Centre Travel Group Limited	4.7%
InvoCare Limited	4.5%
Class Limited	4.3%
Seven West Media Limited	4.1%
IRESS Limited	3.9%
Michael Hill International Limited	3.8%
Blackmores Limited	3.6%
Adbri Limited	3.4%
Bega Cheese Limited	3.3%
Ht&E Limited	3.3%
Top 10	38.9%

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

In addition to yet another variant of Covid 19 hitting the headlines (according to one testing company we spoke with there are many more variants [2500] than Greek letters in the alphabet), investors are also slowly figuring out that interest rates are likely to rise. Should longer term discount rates rise there will be an attendant increase in the cost of capital. In other words, investors will demand a higher return (or more certain return) on their invested capital. We suspect that disruption today with the potential for cash flow tomorrow may no longer be as popular with investors. Our view is that long term bond rates are currently unsustainably low. Central Banks have over-stepped their traditional mandate by engaging in 'unconventional' monetary policies. By extending their reach from shorter term rates to asset (bond) purchases, they have lowered the forward rate curves around the developed world. Generally, Central Banks control the cash rate and allow market forces to dictate the medium and longer term cost of money. Whilst, in theory, Central Banks have unlimited firepower to continue with QE as long as they like the reality is that there must be limits to the size of their balance sheets. The whole process is of course completely circular as Central Banks (being owned by Governments) mop up Government issued debt it's the Government issuing and buying back its own debt.

In addition to massive stimulus and yield curve manipulation we have had a dramatic impact on consumption patterns as a result of Covid 19 lockdowns. The avenues through which consumers could spend money have been funnelled away from services (viz travel, leisure, restaurants etc.) and into physical goods. This has reversed a 30 plus year trend whereby consumers have steadily increased the ratio of their spending on services at the expense of durable goods. Unsurprisingly the world's supply chains have buckled triggering price increases in everything from ocean freight, computer chips through to commodities. Labour has yet to catch up although we have seen shortages emerge where strict travel barriers restrict the natural mobility of labour. The current strikes by our teachers, bus and train drivers reflect concerns that labour has not had its fair share of the inflationary increases and is likely to continue inflation's momentum from goods and asset prices to labour and thus into the broader services economy.

Major Contributors for the Month

Key contributors to performance over the month came from **Seven West Media (SWM.ASX)** which rose 36% on the back of two significant announcements. The first was the acquisition of Prime Media (PRT.ASX) their regional media affiliate for \$132m (\$72m net of cash acquired on the balance sheet). The acquisition multiple was around 2.9x ev/ebitda and there will be substantial overhead savings once merged into SWM. The second was a significant upgrade to their guidance based on strong growth in SWM's market share and increasing shift to digital revenue streams. With the TV business expanding strongly into BVOD (broadcast video on demand), the West Australian adding a paywall and revenue from Google and Facebook all contributing here, digital earnings are on track to be 40% of ebitda in FY 2022. Digital revenue will likely push materially higher in the next few years which the market is yet to fully appreciate at 5.5x ev/ebit.

Michael Hill International (MHJ.ASX) rallied 21% over the month on limited newsflow. We believe the company continues to transition under a strong management team. With substantial net cash on the balance sheet MHJ remains extremely compelling value trading on around under 5x ev/ebit.

Finally the relative performance benefitted from the decline in **ZIP co (ZIP.ASX – not owned)** which declined 20% over the month. This was in spite of the company reporting growth of 30% in TTV in the first quarter of the fiscal year and the closing of its Twisto acquisition in Europe.

Major Detractors for the Month

Against these contributors, relative performance was hurt by strong moves in battery materials company **Novonix (NVX.ASX – not owned)** which rose 62% over the month. NVX currently sells a range of battery testing tools and is working on supplying synthetic graphite to be used in anodes of Lithium-Ion batteries for U.S. made batteries. The company has conditional sales agreements with Samsung and Sanyo and the enthusiasm for the shares has reached new highs since Phillips 66 (a producer of needle coke which is a precursor for the production of synthetic graphite) invested US\$150m in the company in August (albeit at circa A\$2.70 per share vs the current share price of over A\$9 per share). These announcements whilst clearly exciting have yet to materialise in earnings or cash flows for the business which sports a \$4.4bn market capitalisation.

Class Ltd (CL1.ASX) detracted from performance as the shares fell 10% over the month. This is largely explained by the pullback in the HUB24 (HUB.ASX) share price which came off 8% over the month. HUB24 has entered into a scheme of arrangement to acquire Class offering 1 for every 11 shares in Class Ltd plus 10c a share. Whilst the scheme has not yet been implemented the share price of Class is likely to be somewhat linked to the fortunes of Hub 24 in the absence of another superior offer.

Finally, **Flight Centre (FLT.ASX)** detracted from the Company's performance as the shares fell 11% on the back of fears of further restrictions being introduced from yet another variant of Covid 19. Whilst the Omicron variant appears to have a transmission advantage derived from both greater inherent infectiousness and some ability to evade sterilising immunity from our current vaccines, the data out of South Africa increasingly suggests that the vaccines remain protective against serious disease with ICU admissions, intubated patients and deaths from COVID-19 so far rising at a significantly slower pace than previous waves of COVID-19 in the country. We believe countries generally remain committed to re-opening borders now that significant swathes of their population are fully vaccinated and are likely to lift recently imposed travel restrictions (as Switzerland has already done we would note) once more is known about the variant and the reality sets in that travel restrictions will fail to keep the variant from establishing itself in their population in any case. FLT has undergone significant restructuring of its cost base (particularly its leisure business) meaning the company should be able to earn significantly more from this segment once volumes return. The business continues to move business online and to remote working consultants and grow its world leading corporate travel business.

Outlook & Strategy

We remain firmly in the camp that inflation is more likely to be sustained than most market pundits accept currently. The short and medium term drivers of inflation appear strongly in train which is likely to force the hand of Central Bankers to step out of the long term interest rate manipulation game – an arena they arguably should have departed after only a brief foray post the GFC. Whilst many investors are looking for stocks with pricing power, the largest impact of inflation will be rising longer term interest rates which will get reflected in the market's assessment of stock valuations. Whilst we don't hold ourselves out as either macro economists or macro style investors – a view on discount rates is important to bottom up investments. The largest impact of rising rates therefore is going to be on the stocks which have aggressively priced in long distance (if any distance) cash flows and earnings and will likely favour businesses and stocks with decent short and medium term cash flows. We feel our portfolios are relatively well positioned for this move given cash flows remain the bedrock of our investment style.

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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