



Spheria Emerging Companies Limited

Level 35, 60 Margaret Street

Sydney NSW 2000

Telephone: 1300 010 311

Email: invest@pinnacleinvestment.com

ACN 621 402 588

21 July 2020

By Electronic Lodgement

Market Announcements Office
ASX Ltd
20 Bridge Street
SYDNEY NSW 2000

Dear Sir/Madam,

Spheria Emerging Companies Limited (ASX:SEC) – Monthly Investment Update

Please find attached a copy of the investment update the month ending 30 June 2020.

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Investment Update

As at 30th June 2020



Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets⁴
\$1.731

Company⁷ performance p.a.
(since inception)
-2.9%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	\$1.29
Inception date	30 November 2017
Listing date	5 December 2017
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Management Fee	1.00% (plus GST) per annum ¹
Performance Fee	20% (plus GST) of the Portfolio's outperformance ²
Market Capitalisation	\$79.9m

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

Commentary

The Company's pre-tax NTA decreased 1.5% in June, the S&P/ASX Small Ordinaries Accumulation Index decreased 2.0%.

Global markets rose again over June, albeit at a less torrid pace than the previous month. While the month saw a significant re-acceleration in COVID-19 transmission rates in the U.S. and a consequent reversal by many U.S. States of their premature re-openings (with the benefit of hindsight), investors looked through these developments to push the S&P500 to within 8.5% of its pre-COVID highs and the NASDAQ to all-time highs. We believe the enthusiasm for stocks is being driven by a realisation that interest rates are likely to remain at depressed levels for an extended period of time and that Governments will have an incentive to essentially monetise some of their COVID-19 induced debt rather than raise taxes during a recovery from the pandemic.

Locally, the Australian broader markets were led up by the banks as they partially reversed a significant period of underperformance on better sentiment towards expected credit losses in the economy albeit the small ordinaries index struggled to keep up. Value cyclicals began the month well but faded as fears of a second wave both internationally and within Victoria built. Momentum stocks, particularly those of a more conceptual nature (i.e. they don't earn a profit) performed strongly as speculative activity by retail participants in the market appeared to hit a new high. The market continued to see capital raisings both by companies hit by COVID-19 (E.g. Qantas, Vicinity, Challenger, Super Retail Group, Investec Australia Property Fund, Arena REIT, APN Convenience Retail, Sky City, Red Hill Education, Viva Leisure) and by tech stocks taking advantage of historically high valuations to do blank cheque raises (E.g. Kogan, Temple & Webster, Openpay). Additionally, gold stocks were very active funding raisings for further exploration spending given the strong performance of the underlying metal and stocks within the sector. The market saw the re-emergence of corporate activity with Infigen (IFN) receiving two separate takeover offers, two gold explorers / developers receiving offers (Cardinal – CDV and Exore -ERX) and Cromwell (CMW) and Opticomm (OPC) receiving offers.

During the month we added to Corporate Travel (CTD), AP Eagers (APE) and Vista Group (VGL). These positions were funded with selling in Adbri (ABC), Platinum (PTM), Blackmores (BKL) and Appen Group (APX).

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Major contributors to performance were stocks that we owned including:

- ☐ Adbri (ABC, +72bps)
- ☐ Healus (HLS, +54bps)
- ☐ Beacon Lighting (BLX, +28bps)

HLS saw a re-rating post the sale of its troublesome Medical Centres and Dental business for \$500m of enterprise value. This represents 13x EBIT and was a commendable result considering the capital and management intensity of the business. More pertinently it substantially deleverages HLS and allows them to focus on their strong pathology and imaging franchises. BLX had a strong trading update as consumers flocked to stores to undertake DIY projects during COVID-19 restrictions.

Major detractors to performance were:

- ☐ Mortgage Choice (MOC, -44bps)
- ☐ Bega Cheese (BGA, -44bps)
- ☐ Fisher & Paykel (FPH – Not owned, -35bps)

Bega continued to retrace during the month following strong outperformance during the COVID-19 drawdown as investors appeared to use it as a funding source for other positions and in part due to negative sentiment from the catastrophic unwinding of Freedom Foods (FNP – Not owned).

Mortgage Choice appeared to fall on concerns about the sustainability of currently strong levels of application volumes to mortgage brokers.

Fisher and Paykel further re-rated following accelerating global COVID-19 cases given it is a COVID-19 beneficiary in its hospital ventilator business.

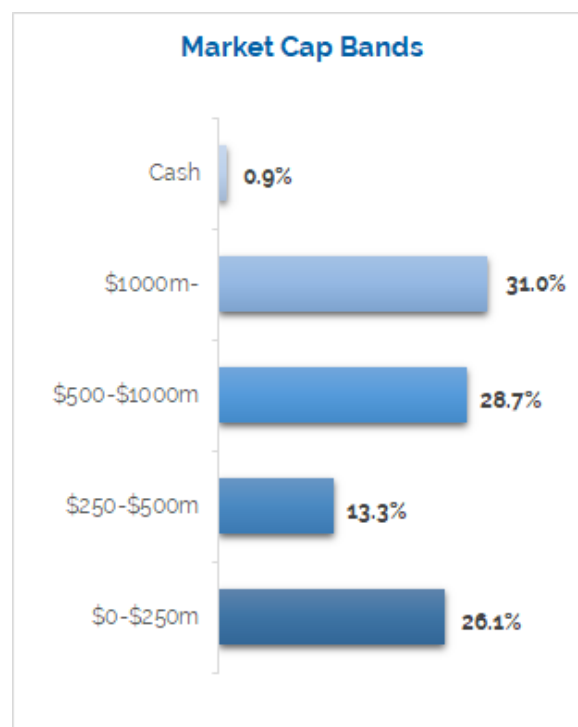
Outlook

While the market has experienced a meaningful recovery from its lows the manager sees the almost historic levels of multiple divergence as providing some exceptional investment opportunities for those prepared to look through short term earnings uncertainty and/or go against the grain. Equity recapitalisation activity continues to present opportunities for active managers to establish positions in quality companies that have seen cashflow impacted by COVID-19. Additionally, there remain a surprising number of companies that continue to operate profitably and generate cash but that remain on highly depressed multiples, particularly towards the smaller end of the market cap spectrum. On the other hand the manager is increasingly concerned about a narrow subset of very highly rated companies (almost invariably with no track record of free cash generation) that appear to have become completely disconnected from fundamentals, particularly in the technology, fintech and biotech sectors. The manager continues to see better opportunities for relative performance in discovering unpopular but strongly cash generative businesses on attractive through the cycle multiples. While revenue and margins in some of these companies may take some time to recover from the impacts of COVID-19 the manager believes they represent better risk-reward opportunities on balance.

Top 10 Holdings

Company Name	% Portfolio
Adbri Limited	4.7
Breville Group Ltd	4.1
Class Limited	4.1
City Chic Collective	4.1
Sims Limited	3.9
Ht&E Limited	3.7
Fletcher Building	3.7
Blackmores Limited	3.6
Healius	3.4
Asaleo Care Limited	3.3
Monadelphous Group	3.2
Top 10	41.9

Source: Sphera Asset Management



Source: Sphera Asset Management

Net Tangible Assets (NTA)³

Pre-tax NTA⁴	\$1.731
Post-tax NTA⁵	\$1.864

³ NTA calculations exclude Deferred Tax Assets relating to capitalised issue cost related balances and income tax losses

⁴ Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses

⁵ Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings

Performance as at 30th June 2020

	1m	6m	1yr	2yr p.a.	Inception p.a. ⁶
Company⁷	-1.5%	-15.9%	-12.0%	-6.2%	-2.9%
Benchmark⁸	-2.0%	-9.2%	-5.7%	-1.9%	1.4%

Past performance is not a reliable indicator of future performance.

⁶ Inception date is 30th November 2017

⁷ Calculated as movement in Company's pre-tax NTA (which includes tax on realised gains/losses and other earnings, but excludes any provision for tax on unrealised gains/losses), assuming the re-investment of any dividends paid by the company

⁸ Benchmark is the S&P/ASX Small Ordinaries Accumulation Index

Disclaimer

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