



Sphera Emerging Companies Limited

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ACN 621 402 588

18 June 2021

By Electronic Lodgement

Market Announcements Office
ASX Ltd
20 Bridge Street
SYDNEY NSW 2000

Dear Sir/Madam,

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

Please find attached a copy of the investment update the month ending 31 May 2021.

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Investment Update

As at 31st May 2021



Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets⁴
\$2.467

Portfolio⁷ performance p.a.
(since inception)
10.6%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	\$2.21
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	\$132.9m

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 portfolio performance for the month of May was 0.1%, while the S&P/ASX Small Ordinaries Accumulation Index returned 0.3%.

Markets

The Smaller Companies index was up very modestly over May however the capital markets have kicked into overdrive. Announced M&A deals (many not completed as yet) were amongst the highest levels the ASX has seen in the last 20 years. The IPO market is also experiencing high levels of activity as entrepreneurs and Private Equity seek to hit the exit whilst the IPO window is open. As is often the case however the rush for the exits eventually fatigues the time, patience and interest of the market and a number of recent attempts to hit the market have been pulled as the finely balanced scales between cynicism and opportunism tip back in favour of the former.

The market concerns around inflation remain highly topical. Tomes have been written on whether we will see inflation and if so for how long this rarely seen mythological beast will continue in our midst. Having said that, the conditions for its re-appearance have never been better. The modern-day conjurers (aka the Cabal of the Central Bankers) have been brewing their caldrons for several years now, perfecting the secret herbs and spices, to make a heady cocktail for its re-appearance. Its little wonder then that the combination of this brew plus the super stimulus from Covid 19 is starting to work through the economic system. Short term observable inflation indicators are up hugely – freight rates have doubled, raw material prices are at record levels, consumer demand and confidence is strong, and we are experiencing a number of supply shortages (computer chips, cars, etc.). Covid induced lack of migration is also biting many industries with hospitality and mining in particular struggling to fill job vacancies. Wage pressure in the West is now fairly extreme although when mobility eases there should be some relief for this pressure cooker. For now, the Cabal has managed to persuade markets that they can conjure up the inflationary beast and yet keep the longer-term impacts in a convenient bottle.

The other area of heightened activity in the market has been the IPO market. We are highly selective with IPO's and approach them with caution. Since the end of September, we have invested in only around 4 out of the 29 IPO's (the total number of raisings above \$30m). Whilst the results of our investments here have been solid, we do not rely on this as a key performance generator for the Company. We typically look for companies with a decent length of financial history and limited to no private equity involvement, solid cash flow generation and a supportive valuation before investing.

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Given the relatively flat month for the market, absolute performance drove the Company attribution over the month.

Major Contributors for the Month

Ainsworth Gaming Technology (AGI.ASX) rose almost 20% over the month as it reported improved trading for its second half. The US gaming market continues to recover from the Covid induced lock downs over the previous year and the company announced a gaming licence deal with US-listed GAN Ltd worth up to US\$30m over 5 years.

EML Payments (EML.ASX – not held), declined 42% as they announced that the Central Bank of Ireland had raised significant regulatory concerns with respect to the two businesses EML had recently bought in the UK (Sentenial and Nuapay). Notwithstanding the recent share price pullback, we remain cautious on the stock given the frequent M&A undertaken by EML, the potential reputational and financial impact of the aforementioned regulatory issues and its still heady valuation (40x EV/EBIT in FY21).

Class Ltd (CL1.ASX) rose 9% over May. CL1 continues to present as an outstanding investment opportunity as reasonably new management lead by Andrew Russell continue to execute against a growing TAM with an expanding product portfolio. Cash generation remains high, notwithstanding increased investment in longer term growth drivers like R&D and Sales and Marketing teams. Finally with rusted on consumers – over a 99% client retention rate – CL1 has significant latent pricing power should inflation become a market reality.

Major Detractors for the Month

Monadelphous Group (MND.ASX) declined 22% over May on the markets continued concerns that the acute labour shortage in WA would crimp margins and stifle MND's ability to bid for new projects. Whilst both concerns have some validity, we think they are shorter term in nature. The re-opening of Australia's domestic travel borders followed by the eventual international border re-opening should alleviate labour cost pressures. Meanwhile record commodity prices which have spurred resource shares to their highs, will very likely lead to increased exploration, resource M&A and new capital projects. At less than 10x EV/EBIT, we believe MND is attractive.

Seven West Media (SWM.ASX) declined 16% over the month on limited news flow. The announcement in late May that Nine Entertainment Co (NEC.ASX) had also reached an agreement with Facebook and Google for content sharing worth in the vicinity of \$30-40m pa continues to give us confidence that earnings are likely to materially recover in FY21 and FY22 with a substantial improvement in the balance sheet. Longer term media consolidation in Australia remains the most likely scenario.

Vista Group International (VGL.ASX) retraced 11% over the month after a strong performance so far this year on Covid concerns emanating from India. This makes little fundamental sense however as many of the markets VGL is exposed to (North America, Europe) are re-opening and cinema attendance is recovering. As the world's leading cinema ERP software firm, we think the market is still underestimating the upside to earnings when cinema exhibition returns to something resembling normality.

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Outlook & Strategy

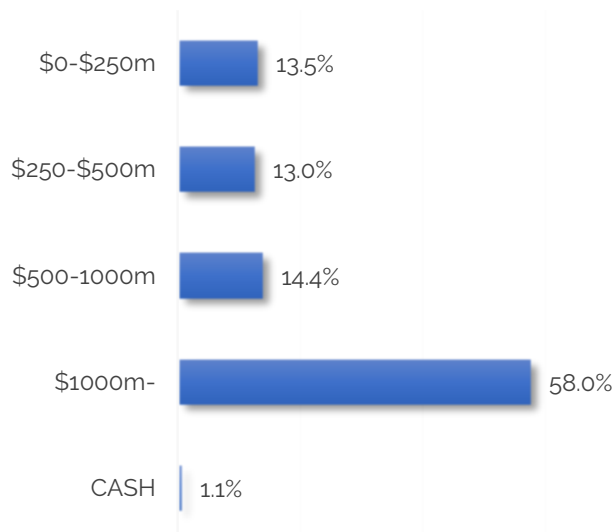
Little over the past few months has allayed our concerns that parts of the market are over-extended. Retail investors have rushed back into the market with fervour. This has pushed areas – especially in micro caps – to levels that are hard to justify on fundamentals. Oddly however there remain pockets of market where there is complete investor disinterest chiefly in areas where there are temporary earnings lags or there is a perception that the sectors are not high growth or disruptive. Should inflationary forces return on a more permanent basis longer term interest rates may continue to rise. We continue to believe adhering to a valuation discipline with this backdrop is the best way to serve our investors over the cycle.

Top 10 Holdings

Company Name	% Portfolio
Adbri Limited	5.1
Fletcher Building	4.6
Healius	3.9
Flight Centre Travel	3.6
City Chic Collective	3.3
Ht&E Limited	3.3
Monadelphous Group	3.2
Corp Travel Limited	3.1
Class Limited	3.0
Blackmores Limited	3.0
Top 10	36.3

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)³

Pre-tax NTA⁴	\$2.467
Post-tax NTA⁵	\$2.412

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 31st May 2021

	1m	6m	1yr	2yr p.a.	Inception p.a. ⁶
Portfolio⁷	0.1%	16.2%	46.0%	9.9%	10.6%
Benchmark⁸	0.3%	10.4%	26.7%	7.9%	8.7%

Past performance is not a reliable indicator of future performance.

⁶Inception date is 30th November 2017

⁷Calculated as the Company's investment portfolio performance after fees excluding tax on realised and unrealised gains/losses and other earnings, and after company expenses. All p.a. returns are annualised.

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

Disclaimer

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