Spheria Emerging Companies Limited
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ACN 621 402 588

18 August 2021

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 31 July 2021.

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Spheria EMERGING COMPANIES

ASX: SEC

Investment Update

As at 31st July 2021

Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets[4]
$2.596

Company[7] performance p.a. (since inception)
11.2%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	$2.29
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 Company's outperformance[2]
Market Capitalisation	$137.7m

[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 performance for the month of July was 0.0%, while the S&P/ASX Small Ordinaries Accumulation Index returned 0.7%.

Markets

Markets rose modestly over July as the market digested the likely positive news from reporting season – lead by some strong early earnings reports in overseas markets countered by the outbreak of the Delta Strain of Covid 19 locally which has seen many States re-initiate lockdowns. New age metal stocks continued to be a highly favoured area for investors with Galaxy Resources (GXY.ASX), Orocobre (ORE.ASX) and Pilbara Minerals (PLS.ASX) all up strongly despite strong performances in previous months. Mining services as a group saw some recovery as the investors re-appraised the inflationary costs impacts against relatively cheap valuations and a recovering topline. At the other end of the ledger were some e-commerce names. These had benefitted enormously from last year's lockdown and are finding it hard to lap extremely high comparable sales and profit margins. For many of these internet retailers last year customers flocked to their websites and they grew substantially with less than usual marketing spend. As the consumer market normalises the cost of customer acquisition has grown substantially with attendant rise in overall marketing costs squeezing margins.

Enter the Matrix

With rates having declined again since the blip in February this year, the market has returned to its matrix-like state. Many investors appear to be ignoring risk or it is deemed irrelevant. In a forgiving market, emboldened by seemingly endless Central Bank liquidity, the reddit army marches on seeking justice against an unknown and largely imaginary enemy. We liken this state to the choice Morpheus offered Neo in the Matrix Movie. Will you take the Blue Pill and re-enter your slumber plugged into the machine or the Red Pill and unplug?

Red-Pill like thinking requires you to unplug from the slumber many investors appear to be in and look at reality. We are in an extremely unusual set of market conditions, largely set by Governments and Central Banks in reaction to firstly the GFC and then the outbreak of Covid. Ultra-loose monetary conditions were a likely cure for the 2008 GFC which, after all was a financial crisis. However, we have used the same prescription to cure the "patient" of an entirely different set of circumstances with Covid. Nevertheless, rates at zero or negative levels are not likely to remain a long-term possibility. Alternatively, if they are the new reality there are multiple other

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repercussions with which the market is yet to grasp. These would include a rapid debasement of monetary purchasing power (aka inflation), a spike in assets likely to protect wealth – viz property, gold, artworks and collectibles and probably severe social repercussions. Sound familiar? Blue-pill thinking is the unthinking adoption of this status quo without thinking about the attendant consequences. Blue-Pill thinking is following the herd into whatever is deemed growthy, disruptive and innovative without any heed to business fundamentals or sustainability of the business.

We recently did a presentation in an attempt to demonstrate the futility of following the crowd into momentum names that did not subsequently back up strong share price performance with fundamentals – that is earnings and cash flow. The study focused on micro caps where there are the greatest proportion of listed companies that lose money, but we believe the analysis would also apply to small caps. We went back and analysed the top 10 performing microcaps in each of the past 7 years to see whether the Sturm und Drang surrounding the best performing short term names proved warranted over time. In most of these years well under 50% of the top 10 made money and in many 8 or 9 of the top 10 names lost money. Inevitably, if these companies didn't subsequently earn money or cash flows these erstwhile fireworks morphed into damp squibs. In every year over the ensuing timeframes (of 2 years or longer) the money-losing high-flyers vanished back into the ether from which they came in many cases literally costing investors everything they invested.

Flipping the analysis on its head we also went back to look at the starting point of the subsequently best performing microcaps over a 10-year period. 9 out of 10 of these names were money making and the consistent trend amongst these names was that they had growing earnings and cash flows and were creating sustainable and durable businesses. As we have said before we prefer to work with probabilities rather than improbabilities. Why gamble on low probability stocks when you can win consistently on higher probability stocks. Cash flows are the beating heartbeat of any great long-term business and eventually all durable businesses generate cash flows.

Major Contributors for the Month

Piedmont Lithium (PLL.ASX – not owned) contributed to attribution as the stock declined 28% over July. Along with many other Lithium names, PLL had been performing strongly as investors size up the potential growth in Lithium demand driven by the likely strong uptake of battery demand for Autos and grid storage. PLL is in various stages of seeking approval for several mines in which it has a whole or part interest across the US, Canada and Ghana. In late July the company put out a release claiming they had not applied for a necessary mining permit variation in Gaston Country (North Carolina) which took the market by surprise. Several Class Action lawsuits have been filed in the US on account of the apparent lack of disclosure. PLL remains pre-revenue and in the resource de-lineation/ permitting phase – a time in a development cycle of mining shares we typically prefer to avoid.

Horizon Oil (HZN.ASX) rose 15% over the month. HZN strengthened on the back of the continued strength in the oil price and an increase in its share capital return from 1.4c to 3c per share of which we engaged with the board earlier in the month in order to help achieve such outcome (subject to shareholder approval at an upcoming EGM). HZN remains a reasonably low-cost oil producer – with cash costs hovering around US$20/bbl and has net cash of US$31m following strong cash generation and the receipt of some option conversions. Whilst oil shares tend to trade on low multiples on account of their limited resource span, HZN is trading on an EV to current years spot operating cashflow of 1.5x despite having around 5 years of operating life based on last reported 2P reserves (less FY21 production).

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Iress Ltd. (IRE.ASX) contributed as it rose 8% over the month on confirmation from IRE that it had received and rejected an offer from EQT Partners (a large Swedish based Private Equity fund) in the range of $15.30-15.50 per share. IRE also released a medium-term organic growth rate target update indicating the group believed they could grow revenue between 5-10% over the medium term. In addition, margins and earnings were indicated to potentially grow faster than current market consensus due to a longer-term shift to the cloud. The Company retained a significant holding in IRESS on account of the large discount to EQT's indicated offer (IRE closed the month at $14.05) and our view that the recent updated guidance had not been fully factored into market valuations.

Major Detractors for the Month

Ainsworth Gaming (AGI.ASX) was the largest detractor as it retraced almost 19% over July on limited newsflow. AGI has been one of the strongest performing shares in the Company over the past year and seems to have fallen in sympathy with the increased Covid Delta variant outbreak in Australia and abroad.

Bega Cheese (BGA.ASX) detracted as the stock declined 12% on concerns that higher farmgate milk prices would potentially squeeze earnings. Whilst input pricing has risen this year, supply still appears to be relatively constrained as dairy farmers are still recovering from drought conditions last year. Herds and farmers take time to adjust to pricing signals before adding capacity. BGA still has substantial cost savings opportunities and synergies from their recent acquisition of Lion Dairy Drinks business. We feel the business is well positioned to perform over the medium term despite some short-term input pressures.

Pilbara Minerals (PLS.ASX – Not owned) detracted as the lithium miner rallied 22% over the month on a continued recovery in Spodumene (Lithium Concentrate) and Lithium Carbonate prices. Although PLS has substantial reserves of Lithium Oxide they are currently barely breaking even as their current cost of production remains high. We continue to hold the view that many of these Lithium mining names look over-valued on longer term assumptions and the inevitable supply response to high lithium prices and demand.

Outlook & Strategy

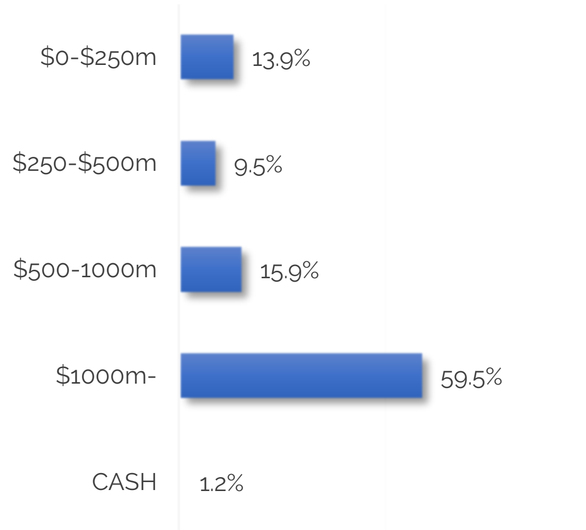
As the market goes through various fixations with sectors and themes our view remains that ultimately earnings and cash flows derive long term valuation and returns. We are clearly at an interesting juncture in time with rising environmental concerns coupled with a likely once in a generation energy transition (or transitions) likely to open up new business streams and opportunities. Mankind is, to give us some credit, a reasonably creative species especially given enough incentive. On the other hand, as the research above demonstrated, new areas, ideas or disruptive business models must eventually make earnings and cash flows to warrant share price performance or meet the market's eventual contempt.

Top 10 Holdings

Company Name	% Portfolio
Adbri Limited	4.8
Fletcher Building	4.5
Healius	3.9
City Chic Collective	3.6
Seven West Media Ltd	3.5
Flight Centre Travel	3.4
Iress Limited	3.4
Monadelphous Group	3.4
Blackmores Limited	3.4
Breville Group Ltd	3.3
Top 10	**37.1**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)[3]

Pre-tax NTA[4]	$2.596
Post-tax NTA[5]	$2.495

[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 July 2021

	1m	6m	1yr	3yr p.a.	Inception p.a.[6]
Company[7]	0.0%	15.4%	54.3%	11.4%	11.2%
Benchmark[8]	0.7%	11.8%	32.3%	9.2%	9.4%

Past performance is not a reliable indicator of future performance.

[6]Inception date is 30th November 2017

[7]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

[8]Benchmark is the S&P/ASX Small Ordinaries Accumulation Index. All p.a. returns are annualised