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21 January 2022

By Electronic Lodgement

Market Announcements Office
ASX Ltd
20 Bridge Street
SYDNEY NSW 2000

Dear Sir/Madam,

Spheria Emerging Companies Limited (ASX:SEC) / Oonthly Investment Update

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

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Spheria Emerging Companies Limited (ASX:SEC)

Investment Update 31 December 2021

Overall Commentary

The company performance for the month of December was 1.3%, very modestly underperforming the S&P / ASX Small Ordinaries Accumulation Index by 0.1%.

The Board of SEC has resolved to pay a fully franked quarterly dividend for the period ended 31 December 2021 of 2.6 cents per share, which will be payable on 31 January 2022.

Company Facts

Investment Manager	Spheria Asset Mangement Pty Limited
ASX Code	SEC
Share Price	$2.50
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	$150.4m

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 December 2021

	1 Month	6 Months	1 Year	3 Years p.a.	Inception p.a[3]
Company[1]	1.3%	8.1%	24.2%	18.5%	12.1%
Benchmark[2]	1.4%	5.5%	16.9%	15.7%	9.6%
Difference	-0.1%	2.6%	7.3%	2.8%	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 and midcap indices were both higher over December despite a significant pull back in the small cap tech sector driven by concerns about rising interest rates and the resulting implications for valuations. Resource stocks outperformed industrials over the month as commodities were largely higher across the board with lithium, iron ore and oil in particular being standouts. Despite the concerns about rising interest rates gold rose 3% over the month and gold equities performed reasonably well. Property names also outperformed despite concerns about rising yields for Government debt, perhaps showing that investors believe they could be effective hedges against rising inflationary expectations. The losers during the month were dominated by expensive technology stocks, particularly those that have yet to demonstrate sustained profitability with Imugene (IMU.ASX), Sezzle (SZL.ASX), Dubber Corp (DUB.ASX), Novonix (NVX.ASX), Australian Strategic Materials (ASM.ASX), Life360 (360.ASX), Mesoblast (MSB.ASX), Zip Co (Z1P.ASX) and PPK Group (PPK.ASX) all down > 15% over the month as the market became concerned about the impact of rising discount rates on their long dated (potential) cashflows. Surprisingly perhaps given the local newsflow, most re-opening trades were fairly flat for the month after falling over the back part of November on the emergence of the Omicron strain.

Net Tangible Assets (NTA)[1]

Pre-Tax NTA[2]

$2.699

Post-Tax NTA[3]

$2.582

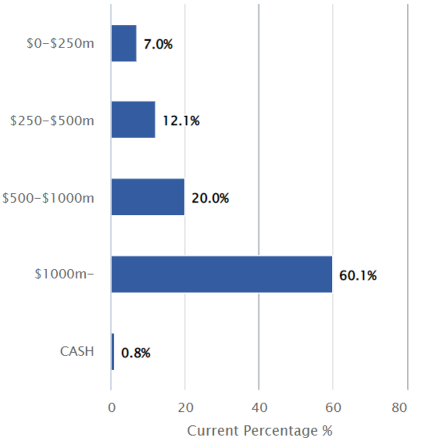
1 NTA calculations exclude Deferred Tax Assets relating to capitalised issue cost related balances and income tax losses.
2 Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.
3 Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings.

Top 10 Holdings

Company Name	% Portfolio
Flight Centre Travel Group Limited	4.6%
InvoCare Limited	4.6%
Class Limited	4.4%
Michael Hill International Limited	4.3%
Blackmores Limited	4.2%
Seven West Media Limited	4.2%
IRESS Limited	3.9%
HT&E Limited	3.9%
Bega Cheese Limited	3.4%
Breville Group Limited	3.4%
Top 10	**40.8%**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

M&A activity was once again elevated during the month with BGH bidding for IVF provider Virtus Group (VRT.ASX) and IGO Group (IGO.ASX) finally making a cash offer for nickel miner Western Areas (WSA.ASX) after stalking it for some time. Meanwhile Humm Group (HUM.ASX) announced it had received proposals to acquire all or parts of its business and lithium developer Prospect Resources (PSC.ASX) announced the divestiture of its flagship Arcadia hard rock lithium project in Zimbabwe to lithium-ion battery producer Zhejiang Huayou Cobalt Co. Finally, Helloworld (HLO.ASX) sold its interest in its Australia and NZ focused corporate travel business to specialist global player Corporate Travel Management (CTD.ASX) for a combination of cash and scrip.

The Portfolio very modestly underperformed as the drag from its overweight to workforce productivity software supplier Nitro (NTO.ASX) and apparel retailers City Chic Collective (CCX.ASX) and Universal Group (UNI.ASX) outweighed strong performance from low multiple consumer names like HT&E (HT1.ASX) and Michael Hill (MHJ.ASX).

Major Contributors for the Month

HT&E (HT1.ASX) was the largest contributor as the stock rose 18% during the month. HT&E completed the previously mooted liquidation of part of its holding in online travel provider Luxe Group (owner of the Luxury Escapes brand) demonstrating the value in some of its smaller and less well understood assets. We still see significant valuation upside in the stock on a sum of the parts basis. In our view the market is either ascribing a much lower than average through the cycle multiple to the core audio franchise or assuming a level of permanent earnings impairment that is at odds with evidence from international audio markets.

Michael Hill International (MHJ.ASX) contributed as the stock returned 15% over the month. The retailer of fine jewellery in Australia, New Zealand and Canada provided a strong earnings update just prior to the end of the month flagging an EBIT result “well above” that achieved last year (excluding the one off jobkeeper subsidy) despite a significant impact from the delta lockdown over July through October in its key NSW and Victorian markets. While the Omicron outbreak and people reducing exposure on a voluntary basis may impact second half trading, we are hopeful there should be less disruption over the key Valentines and Mother’s Day trading periods and would note that the business is cycling a very harsh lockdown of its Canadian operations over much of the 2H21 period. While there is some noise in the data, it is clear management of Michael Hill have presided over an extremely impressive turnaround of performance since the MD joined the business at the end of 2018 that is only now starting to be somewhat appreciated by the market. We see the firm as well placed to leverage its strong existing market position, robust profitability and cashflows and strongly net cash positive balance sheet to pursue growth opportunities not discounted by the current share price.

Novonix (NVX.ASX – Not owned) contributed as the vendor of battery testing tools and aspiring manufacturer of synthetic graphite battery anodes retraced 23% alongside many other unprofitable technology stocks that are on eye watering revenue multiples. Novonix has conditional sales agreements with Samsung and Sanyo and the enthusiasm for the shares reached new highs in November/early December after 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 staggering A$4.6bn market capitalisation.

Major Detractors for the Month

Nitro (NTO.ASX) was the largest detractor as it retraced 30% in sympathy with other technology stocks yet to demonstrate profitability. We are generally more sceptical than the average smaller company investor when it comes to extrapolating revenue growth trajectories into sustained positive cashflow but we like Nitro’s demonstrated ability to win and onboard Fortune 500 level corporates with its core document productivity solution (competing head-to-head with the US$252bn market cap company Adobe). We also see it as well placed to cross sell its newly acquired higher security level e-signing technology (Connective) into its document productivity customer base and vice versa. With a solid net cash position of cA$60m and a modest cash burn we believe the high incremental gross margin and rapid revenue growth of the business makes it very likely that NTO.ASX can achieve sustained robust profitability and cashflows. At c4.5x forecast 1 year forward revenue, we believe NTO.ASX screens well relative to other global, scalable software providers.

Universal (UNI.ASX) detracted as the stock fell 11% over December. We felt the November trading update Universal provided was very solid in the circumstances with the business reporting some impact from the delta lock down mandated store closures but continuing to generate terrific profitability. While Omicron may have some impact on trading in the second half (more likely around staff availability given the customer cohort tends to be at low risk of serious illness) we think the stock screens well at c13x FY23 forecast PE for the growth prospects still ahead of it from store rollout, comp growth and online sales.

Iluka (ILU.ASX – Not owned) detracted as the mineral sands producer rose 17% during the month. The company released a mineral resource estimate for two of its Wimmera mineral sands deposits in Victoria during the very back of November that appeared to generate some excitement amongst investors and analysts. These deposits were discovered in the 1980’s but contain impurities in the zircon that absent a processing solution to remove them make the zircon ineligible for sale into most end markets. One of these deposits is currently the subject of a PFS that would include the use of an innovative processing solution that would unlock this province if successful and potentially generate additional feedstock for a potential future rare earths refinery Iluka may build to process Eneabba monazite.

Outlook & Strategy

We see the market as fairly precariously balanced with COVID-19 induced supply shortages and the pandemic induced shift of global purchasing power to goods leading to rising inflationary cost pressures. These are likely to impact margins for business models without real pricing power on the one hand and heap pressure on Central Banks to raise interest rates (at least nominal rates) on the other with negative resultant implications for the valuations of cash burning concept stocks with long dated (and by definition highly uncertain) future cashflows. The rampant spread of the Omicron variant adds to this uncertainty given its potential for reduced consumer expenditure in face-to-face channels and logistical bottlenecks in supply chains as workers convalesce upon a positive diagnosis or isolate upon exposure to confirmed positive cases. Nevertheless the experience of South Africa shows there is light at the end of the Omicron tunnel with cases, hospitalisations and even deaths all now well down from their peak in the first impacted province of Gauteng (home to the Capitol Pretoria and the major commercial hub Johannesburg). We remain confident that services will eventually trend back towards their historical share of consumption and GDP. We therefore remain constructive towards businesses with a track record of profitability and cash conversion (alongside a solid balance sheet) even where they have been hurt by the pandemic. On the flip side, we continue to avoid capitalising profits of companies that have been boosted above a sustainable baseline by COVID-19 induced behaviours.

We would expect a significant number of short-term earnings downgrades from Omicron and hope to selectively take advantage of these where the market is capitalising a more negative long-term outlook than we feel is reasonable. We continue to be positioned in stocks with significant valuation support, proven business models and good balance sheets as we expect M&A activity to remain robust given the procyclical nature of boards, corporate balance sheets being well cashed up and equity and debt capital remaining cheap and readily available. There continues to be pockets of the market (those leveraged to popular thematics) that appear well and truly overvalued. We continue to avoid these given a market that is inherently inefficient and regularly presents us with opportunities for rotation into names that satisfy our requirements on cashflow, balance sheet strength and valuation.

Fund Ratings

Zenith RECOMMENDED

Further Information

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

Disclaimer