Spheria Emerging Companies Limited
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12 August 2022

Market Announcements Office
ASX Limited
Exchange Centre
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 for the month ending 31 July 2022.

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Overall Commentary

The Company performance for the month of June was +6.6%, which under-performed the S&P / ASX Small Ordinaries Accumulation Index by 4.8%.

Company Facts

Investment Manager	Spheria Asset Mangement Pty Limited
ASX Code	SEC
Share Price	$1.96
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	$117.9m

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.

Performance as at 31st July 2022

	1 Month	6 Months	1 Year	3 Years p.a.	Inception p.a[3]
Company[1]	6.6%	-8.4%	-8.6%	6.6%	6.6%
Benchmark[2]	11.4%	-6.6%	-10.9%	2.5%	4.7%
Difference	-4.8%	-1.8%	2.3%	4.1%	1.9%

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 domestic small and mid-cap indices rallied strongly over July with both indices up over 10% for the month. The biggest driver of markets continues to be inflationary expectations and the flow through effects to long term (10-year bond) discount rates. Although inflation prints around the world continued to show year-on-year growth, there is an increasing expectation that the rate of change in inflation will likely slow. This makes some sense to us given a large part of the inflation base has been driven by energy prices and industrial commodities (Copper, Aluminium and Iron Ore to name the majors). Wage pressures however continue to rise as organised labour pushes for at least no real wage decreases in annual wage negotiations. Wages tend to lag actual inflation especially during volatile inflationary periods such as those we have just witnessed.

Net Tangible Assets (NTA)[1]

Pre-Tax NTA[2]

$2.208

Post-Tax NTA[3]

$2.228

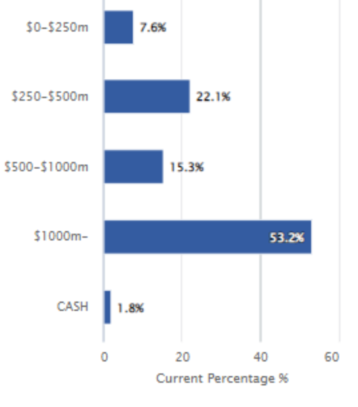
1 NTA calculations exclude Deferred Tax Assets relating to capitalised issue cost related balances and income tax losses.
2 Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.
3 Post-tax NTA includes tax on realised and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

Top 10 Holdings

Company Name	% Portfolio
Blackmores Limited	5.5%
InvoCare Limited	5.5%
Flight Centre Travel Group Limited	4.8%
IRESS Limited	4.7%
Monadelphous Group Limited	4.3%
Michael Hill International Limited	4.3%
Breville Group Limited	3.7%
Vista Group International Limited	3.3%
INSIGNIA FINANCIAL LTD.	3.2%
Adbri Limited	3.2%
Top 10	**42.4%**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Whilst Central Bankers were doing their darndest to create inflation, having released the monster they are trying vainly to re-bottle it or at least contain it to target levels. It's not super surprising then that the Australian Government has announced a wide-ranging review of the RBA's objectives, the interaction of monetary policy with fiscal and macroprudential policy, including during times of crises. This is no small review. The Fed and ECB had the sense to do their own reviews without waiting for respective Governments to figure out the need. All have made some fairly drastic policy errors during the Covid crisis. The purchasing of 10-year government bonds by all must rank up there as one of the least necessary and most expensive unconventional acts. Having said that, the decline in 10-year bonds from around 3.65% at the end of June to circa 3% by the end of July, has started to chase away the bears. Over the month the best performing sectors were technology, healthcare and industrials with energy and consumer staples being the laggards. This was a turbulent rebound with investors picking up the pieces to put risk on. BNPL player ZIP Co (Z1P.ASX), Megaport (MP1.ASX) and Life 360 (360.ASX) were amongst the top gainers for the month, none of whom currently make earnings or positive cash flow.

Major Contributors for the Month

Due to the strong appreciation in the index the most significant attributions came from stocks not owned by the company that either declined in absolute terms or didn't rise as significantly as the index. Contributors here included Champion Iron (CIA.ASX) down 11%, NIB Holdings (NHF.ASX) off 2% and Elders (ELD.ASX) down 10.5% over the month. Positive contributions from stocks owned included:

Universal Stores (UNI.ASX) – rose 19% over the month, recouping some of its losses over the past few months. With a backdrop of rising interest rates and high energy prices it's been easy to sell consumer discretionary stocks. Shooting first and asking questions later, however, can sometimes be a poor strategy. UNI remains one of the few genuine growth stories in retailing in Australia. Having opened 13 stores since their IPO they now have 78 stores and have officially launched their second brand – Perfect Stranger. Perfect Stranger began life as an own brand offered within the Universal Store and has proven successful enough to warrant its own roll out. The remaining roll out of Universal and the potential for Perfect Stranger means UNI could almost double its current footprint of stores without having to go offshore – an option that remains on the table. Trading on a forecast 9x EV/EBIT with a net cash balance sheet, we don't think the shares are on a demanding valuation for the opportunity ahead of this brand and management team.

Seven West Media (SWM.ASX) – rallied 16% over July in sympathy with the market recovery. There was limited news flow out on SWM outside of their attempt to cancel their TV deal with Cricket Australia. The market has sold media names down aggressively over the past several months on the premise that a tough consumer environment would translate into much tougher media spending. Media names tend to be cyclical, and any downturn sees spending cuts. On the other hand, SWM has generated substantial cash since the last media spending downturn and goes into any potential cycle with a much-improved balance sheet. Valuation at SWM remains extremely compelling trading on an EV/EBIT multiple under 4x.

HT&E (HT1.ASX) – a little like its SWM counterpart, HT1 rallied strongly in July with the market sentiment recovering from the June lows. HT1 announced the completion of its sale of Brisbane based 4KQ for $12m in early July for a healthy 12x EV/EBITDA multiple to Sports Entertainment Group (SEG.ASX). This divestment was required by ACMA following HT1's acquisition of Grant media in January this year. This perhaps highlights the latent value in HT1 as the entire business trades on less than 4x EV/EBIT presently which reflects the overwhelmingly negative view the market has on the radio segment.

Major Detractors for the Month

Bega Cheese (BGA.ASX) – declined 9% in July as cost pressures continued to weigh on sentiment for the company. We have detailed our views on BGA in the previous monthly report but in short, we believe the current share price is capitalising the current challenging (and cyclically low) conditions in which BGA finds itself. Whilst BGA does carry some debt on its balance sheet post the LDD (Lion Dairy Drinks) deal, the business has gone through a substantial investment in its capital base and will generate decent cashflows in this downturn. As raw materials cost pressures eventually abate, we expect to see substantial recovery in the earnings base of BGA.

Iress Ltd (IRE.ASX) – was essentially flat over July costing performance on a relative basis. During July the CEO of Iress, Andrew Walsh, announced his intention to retire. The company also re-iterated first half guidance within the previous range (albeit at the lower end). IRE is extremely cash generative and has an incredibly embedded client base. Whilst valuation isn't absurdly low, we feel the growth rate, plus cash conversion justify the multiple IRE trades on currently.

Nitro Software (NTO.ASX) – fell 14% over July. When you are out of favour, you are out of favour. For NTO this month it was 'damned if they do and damned if they don't'. Earlier in the year NTO surprised us and the market by announcing another year of heavy investment in Sales and Marketing and R&D expenditure thus pushing out their cashflow break-even date in exchange for continued strong sales growth targets. The market promptly dumped the shares. Upon deliberation the company re-examined the current market environment (including a likely more challenging macro economy) and announced a pull back on business investment with an attendant reduction in sales growth but substantially bought forward the cashflow break-even date – a decision that we broadly support. The market reacted by promptly selling the shares – again! There is no pleasing some. We remain positive on the longer-term outlook for NTO despite it winning the short-term unpopularity contest. NTO continues to win large new corporates to its PDF productivity platform including P&G, Novartis, Nestle and UGL. Client retention rate remains high at around 94% and they arguably have one of the leading e-signing and e-ID businesses within their portfolio (Connective acquisition made in Europe). Typically, SAAS businesses are favoured investments by investors and trade on high multiples (on both an EV/EBIT and EV/Sales basis) on account of the business' strength. NTO currently trades on less than 3x EV/Sales. NTO's revenue will grow over time and margins should reach industry averages of 20-30%. Projecting forward a few years, it's possible to argue that you are buying NTO on mid-single digit EV/EBIT. In time, this may retrospectively be viewed as a highly lucrative entry point into the stock.

Outlook & Strategy

Market volatility is a reaction to the unusual global times we find ourselves in. The world markets are coming to terms with an end to huge government stimulus programs and record levels of QE intervention from Central Banks. Throw extremely high short term inflation numbers into the mix and the market gyrations almost make some sense. Although the yield on Australian 10-year bonds have compressed materially over the past 6 weeks (from around 4.2% at their peak in mid-June to around 3.0% at the end of July) we believe we have entered an era of higher rates and higher inflation than that of the past decade. This will mean valuation centric investors and those paying heed to fundamentals are more likely to outperform. The market has already rotated out of aggressively cash burning businesses and we still expect to see some further rationalisation as wary investors remain reluctant to throw additional capital at these companies.

Fund Ratings

Zenith

RECOMMENDED

Further Information

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

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