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15 December 2022

Market Announcements Office
ASX Limited
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 30 November 2022.

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Spheria Emerging Companies Limited ASX: SEC

Investment Update 30 November 2022

Overall Commentary

The Company performance for the month of November was 0.9% underperforming the S&P/ASX Small Ordinaries Accumulation Index by 4.0%.

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share Price	$1.89
Inception Date	30 November 2017
Listing Date	5 December 2017
Benchmark	A&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	$113.7m

[1] Calculated daily and paid at the end of each month in arrears.
[2] Against the Benchmark over each 6-month period to a high-water mark mechanism

Performance as at 30 November 2022

	1 Month	3 Months	1 Year	3 Years p.a.	Inception p.a[1]
Company[2]	0.9%	-3.0%	-13.9%	5.6%	6.3%
Benchmark[3]	4.9%	-0.8%	-14.0%	2.6%	4.4%
Difference	-4.0%	-2.2%	0.1%	3.0%	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 30 November 2017. Past performance is not a reliable indicator of future performance. All p.a returns are annualised.

Net Tangible Assets (NTA)[1]

Pre-Tax NTA[2]

2.192

Post-Tax NTA[3]

2.224

[1] NTA calculations exclude Deferred Tax Assets relating to capitalised issue related balance and income tax loses.

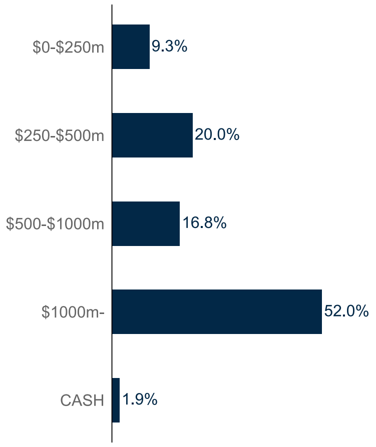
[2] Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.

[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	4.9
InvoCare Limited	4.7
Nitro Software Limited	4.4
IRESS Limited	4.2
Blackmores Limited	4.2
Michael Hill International Limited	3.8
INSIGNIA FINANCIAL LTD.	3.5
Deterra Royalties Limited	3.3
Universal Store Holdings Limited	3.2
Technology One Limited	3.2
Top 10	**39.4**

Market Cap Bands



Source: Spheria Asset Management

Markets

November was a strong month for share markets globally with both the Small Ordinaries and the Mid-Small Index rallying almost 5% each. Other markets were also up sharply with notable performances from the Eurostoxx up 9.1% and the Hang Seng leading the charge with a 21.5% rebound in A$ terms. The rebound appears to be largely driven by 10-year bond yields falling on the back of generally reducing pressures on inflation. We have been suggesting that there were many forces likely to drive inflation down including falling commodity prices, an unwind of the extreme pressure on goods trade (driven by the Covid surge followed by massive overstocking in the retail system globally) which in turn was driving down shipping and production costs in Asia. This has started to manifest in reported numbers which has got people thinking about when the current rates cycle may peak – possibly sooner and at a lower peak than previously thought.

Our sense is that the real economy will continue to slow in reaction to rate rises and some decisions around energy supply which are now causing system wide price increases. Pressures are being felt along the value chain with companies warning about margin pressures and deferrals in top line spending. In some cases, this is causing outsized reactions in share prices which is offering us opportunities in the small cap space. Whereas we were in a market where people would pay any price to OWN certain stocks, we have shifted to a market in which some people will ACCEPT any price NOT to own certain stocks. This flip in view can create opportunities for longer term and more fundamentally based investors.

Major Contributors to Performance

Positive performance contributions from companies owned included:

Ainsworth Game Technology (AGI.ASX) – rose 58% in November post their 2022 AGM. The business announced they expected 1H23 PBT to be approximately $18m compared to the $10m earned in 1H22 and a significant increase from the losses experienced in 2021. This was driven by ongoing growth in North America with an increase in the number of machines and sales in new and existing revenues. We wrote about AGI in the prior commentary noting the positive momentum experienced at the full year result as the business emerged from COVID. The company generated $45m of free cash flow (before tax) in FY22 and now sits on +$50m of cash (no debt) and has valuable property in Las Vegas (+$50m). Despite the rally in November, we still feel the business offers value trading on about 7-8x EV/EBIT and returning to growth under a new management team.

Supply Network (SNL.ASX) – rallied almost 23% in November after the company revealed its half year performance guidance at its 2022 AGM. Revenue guidance implies growth of 21-22% in 1H23, after an already impressive 23% growth over the previous period. Group ebit margins are also expected to remain resilient at around 15%. What is particularly impressive about this result is that margin expansion has not come at the expense of raising prices or expanding Gross Margins. GM has been constant over the medium term at around 42% and the expansion of operating margin has come with operating efficiencies driven at the business level (staff overhead, freight costs and bad debt charges). ROIC has also risen from 32% to 50% in the last 12 months. SNL continues to win market share in a highly fragmented truck parts market with a long tail of smaller competitors.

Bravura Solutions (BVS.ASX) – fell 35% over November after the company announced a strategic business update and FY23 guidance. At the beginning of November, the company advised the market it was now expecting to be loss making in FY23 with EBITDA guidance 70% below consensus seeing its share price fall over 50% post the announcement. The fall was driven by weak demand in their UK business, inflationary pressures particularly in labour which makes up 70% of their cost base and sub-optimal capital expenditure. New management was appointed just months prior to this update and we felt it was their way of 'kitchen sinking' the earnings. We recently modelled the business after the share price had collapsed over 50% in 2022 (and 80% from its peak in 2019) pre-announcement. The business provides critical SaaS software to the wealth management industry, with long term customer contracts of 5-7 years. Whilst we acknowledge the business has made mistakes, we felt the share price move on the day was an overreaction and hence we bought into the weakness. At its lows you were buying the business on 3-4x normalised earnings (EBIT) with a substantial amount of net cash on the balance sheet. The shares have rallied around 30% from our entry price on the day of the warning making the investment a contributor over the month.

Major Detractors from Performance

City Chic (CCX.ASX) – share price fell 39% in November after the company delivered a weaker than expected trading update at its 2022 AGM. The company's share price has been under pressure since its financial year result in August after the company revealed weaker gross margins and balance sheet moving from net cash in FY21 to modest net debt. Management had, like many other retailers, made the decision to increase inventory to ensure there was sufficient stock to meet demand. As demand waned from high levels however, CCX has been caught with significantly higher stock levels than it would usually have. We believe the share price fall has created an opportunity to buy a business at a significant discount to our view of its intrinsic value. The core driver of their earnings continues to be their Australian City Chic store business. Given the share price weakness you are buying the Australian business for ~5x normalised EBIT with potentially more upside for profit turnarounds at its international online businesses – Avenue (US based) and Evans (UK based).

Seven West Media (SWM.ASX) – fell 21% in November after the company provided a trading update at its 2022 AGM. For the first quarter, Seven secured the #1 national total TV share of 40.2% in a market that was down 6%. However, the company is expecting 1H23 revenue to decline 8% or 2% adjusting for the Olympics, which suggests a softer Q2. They also revised costs marginally higher compared to their outlook statement provided in August, which we believe is a good result in the current inflationary environment. The share price performance in November feels like an overreaction to the update and more a reflection of the macro backdrop as discussed in the commentary on HT1, both of which are exposed to advertising spend. We have been impressed with the transition the business has made over the last few years - paying down debt, investing in digital and regaining its TV audience share, which has driven revenue and earnings. Despite the considerable improvements to the business the company trades on 3x EV/EBIT.

Here, There and Everywhere (HT1.ASX) – share price fell 12% in November, underperforming the market after the company provided a trading update. The company announced that radio revenues for Q3 were up 7% vs Q322, however overall H2 revenues were pacing at low to mid-single digit growth comping a strong Q421 as businesses emerged from COVID lockdowns. Whilst still a positive result given the macro backdrop, the market was expecting ~7% revenue growth for the second half. HT1 share price has been under pressure for the last year and we believe this has been driven more by the macro-economic backdrop than company fundamentals. With the market fearing an economic slowdown and a potential recession advertising companies have been unfairly punished. Radio audiences remain resilient with a record high audience in 2022. As we have touched on in prior commentaries the business is investing in digital, pulling out synergies from their recent acquisition of regional broadcaster Grant buying back stock and managing costs well. Trading on <4x FY23 EV/EBIT we believe the company offers tremendous value for long term shareholders.

Outlook & Strategy Going Forward

The move in markets over the past few months reflects a fairly dramatic shift in sentiment around mid-term interest rates. Whilst we are broadly of the view that inflation will be tamed, we harbour some concerns over the short to medium term around the real economy. Companies are laying off staff, energy costs are rising and interest rates are starting to bite. Against this, investor skittishness is providing sporadic and to us, highly attractive, investment opportunities which suits our style of investing. Lastly, Private Equity firms are clearly on the hustings having raised substantial sums of money (for which they earn no fees until said capital is deployed). As rates find a level and if opportunities continue to present themselves our sense is that several of our cash generative and reasonable to lowly geared companies may find themselves in the crosshairs of these investors.

Fund Ratings

Fund Ratings

For more information, please contact Pinnacle Investment Management Limited on 1300 010 311

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Link to the Product Disclosure Statement
Link to the Target Market Determination

For historic TMD's please contact Pinnacle client service Phone 1300 010 311 or Email service@pinnacleinvestment.com

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