Spheria Emerging Companies Limited (Company)
Level 25
Australia Square Tower
264 George Street
Sydney NSW 2000

Telephone: 1300 010 311
Email: invest@pinnacleinvestment.com
ACN 621 402 588

10 January 2024

By Electronic Lodgement

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 31 December 2023.

For further information, please contact 1300 010 311.

Authorised by:

Calvin Kwok
Company Secretary

Spheria Emerging Companies Limited ASX: SEC

Investment Update 31 December 2023

Overall Commentary

The Company returned 13.1% (after fees) during the month of December, outperforming the S&P-ASX Small Ordinaries Accumulation Index by 5.9%.

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share Price	$1.980
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	$118.4m

[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 31 December 2023

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Company[1]	13.1%	13.9%	15.0%	5.6%	9.6%	7.0%
Benchmark[2]	7.2%	8.5%	7.8%	0.9%	6.4%	4.2%
Difference	5.9%	5.4%	7.2%	4.7%	3.2%	2.8%

[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]

2.340

Post-Tax NTA[3]

2.305

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

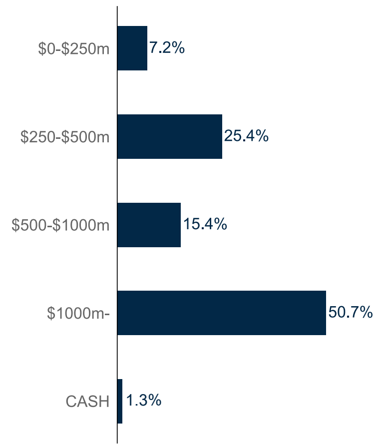
[2] Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses.

[3] Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings.

Top 10 Holdings

Company Name	% Portfolio
Link Administration Holdings Limited	5.7
IRESS Limited	5.3
Adbri Limited	4.9
Bega Cheese Limited	4.3
Supply Network Limited	3.8
Vista Group International Limited	3.7
Deterra Royalties Limited	3.4
A2B Australia Limited	3.1
Bravura Solutions Limited	3.0
Breville Group Limited	2.9
Top 10	**40.0**

Market Cap Bands



Source: Spheria Asset Management

Markets

December was an extraordinary month for the Company. With corporate activity having taken a bit of a backward stance during the latter part of the year, it came back with a vengeance in December. A total of three (A2B Ltd (A2B.ASX), Link Administration Holdings (LNK.ASX) and Adbri (ABC.ASX)) of the Company's holdings received firm bids during the month. What drove this appears to have been the confluence of two factors – firstly valuations were low in all of the names attracting bids, secondly there is now a building consensus that interest rates are likely to have peaked in the US and not far off their peak in Australia. We support this view on the basis that the remarkable events around Covid ended up being a co-ordinated super inflationary event which has since been unwound. The monetary tightening globally, higher interest rates and the re-opening of economies has seen a lot of excess liquidity drained from global economies and production bottlenecks unwind. Supply chains have largely normalised. In China we are seeing deflation – yes you read that correctly – deflation with consumer prices down 0.5% YoY and producer prices (the prices manufacturers broadly charge for goods) down 3% YoY.

Consumers are struggling in Australia with retailers reporting very tough trading environments, however, housing prices remain strong and unemployment relatively low. These are confusing signals for the RBA to interpret. Nonetheless we would expect an easing bias late in 2024 assuming domestic inflation rates continue to be downward trending – which we think likely. This backdrop should be relatively kind to small cap investors. Small caps have materially lagged large caps over the past two years (smalls^ have underperformed by 14% and micros^ by 27% vs. the ASX 100 to 31 December 2023). The December rally in small caps was mirrored by large caps meaning the underlying performance gap still remains. If the interest rate environment continues to ease, we would suspect a relatively supportive environment for small and micro caps over the next year.

Major Contributors to Performance

Over the month the largest contributors to performance were from overweight positions in Link Administration Holdings (LNK.ASX, +59%), Adbri (ABC.ASX, +47%), and Vista Group International (VGL.ASX, +30%).

Link Administration Holdings (LNK.ASX) share price rallied nearly 60% during the month after the company received a takeover offer from Mitsubishi UFJ Financial Group. Link shareholders will receive $2.10 plus a $0.16 cash dividend (25% franked) which represented a ~33% premium to the prior day's closing price and a ~63% premium to the 3-month volume-weighted average price. We have discussed LNK in prior commentaries as the share price had come under pressure in the last year due to legal proceedings relating to its Funds Solution (LFSL) division in the UK, as well as the surprise loss of a large client (HESTA) representing 10% of divisional revenue in June 2023 which sent the company's share price into a tailspin. We entered the name in late calendar year 2022 on valuation grounds (having never owned the company since it listed in 2015) and subsequently bought more over the last year as the share price retraced further. Whilst the bid is opportunistic, we think the significant premium offered and the risk-reward given the Company's relatively high gearing levels means the deal is highly attractive to shareholders. The takeover validates the significant strategic value on offer with Link Market Services (share registry and employee share plans) being the second largest player in Australia and NZ, third in the UK and second in India, whilst the Retirement & Superannuation Solutions (RSS) business is the largest administrator in the industry fund space in Australia.

Adbri (ABC.ASX) share price rose 47% in December after it received a non-binding proposal from CRH and the Barro Group to acquire 100% of the company for $3.20 per share which represented a 41% premium to the last closing price. CRH is a leading global building materials company with strong market positions in North America, Europe and growing presence in Asia and South America. As we understand CRH will be buying out minority shareholders with the Barro group retaining its 43% interest. Given CRH has only a small existing presence in the Australian market the deal is not expected to face any notable competition hurdles. ABC has been a long-term holding of the Company, but its share price has come under pressure in the last few years due to several factors including an irrational industry pricing environment, a material loss of lime volumes in respect of long-term supply agreement and balance sheet pressure from higher-than-expected capital expenditure on their Kwinana project upgrade. With these issues now largely resolved the group was looking forward to significantly improved returns for shareholders which has likely prompted the CRH/Barro consortium to pounce on the balance of the company at this point in time.

Major Detractors from Performance

The largest detractors from performance included ***not owning*** Neuren Pharmaceuticals (NEU.ASX, +61%), and overweight positions in Southern Cross Media (SXL.ASX, -5%) and Technology One (TNE.ASX, -2%).

Neuren Pharmaceuticals (NEU.ASX) – **not owned** rose 61% in December. NEU detracted from relative performance due to its weight in the index. Neuren is a biopharmaceutical company that is developing new drug therapies to treat highly debilitating neurodevelopment disorders that emerge in early childhood, with their approved drug trofinetide (sold under "Daybue") treating Retts syndrome. The strong share price performance over the month comes as the company announced positive results from its Phase 2 trial of Phelan-McDermid syndrome (rare genetic condition that causes developmental and speech delays, behavioural problems and a weakening/no ability to feel pain or sweat).

Technology One (TNE.ASX) share price fell 2% over the month on no significant company news but underperformed the index. TNE delivered their FY23 result in November with Annual Recurring Revenue (ARR) growing 23% and NPAT growing 16%, both were ahead of guidance. The business pulled forward their $500m ARR target to FY25 (previously FY26) and set a new target to hit $1bn of ARR by FY30. The business has undergone a transition since 2018 of being an on-premise legacy software business to a cloud SaaS business which has unlocked a significant pathway for growth. TNE has an incredibly loyal customer base with net retention rate (NRR) of 119% and very little customer churn. TNE has been a long-term holding of the Company and we continue to support the business with its strong growth pipeline, net cash balance sheet and solid cash conversion despite a relatively full valuation.

Outlook & Strategy Going Forward

Fairly evidently, we are constructive on smaller companies in 2024. Whilst it's true that – to paraphrase Buffett – you should never ask a small-cap manager if its time to buy small caps* – we still think it's about the right time to buy small caps. Just as many investors have moved capital into the relative safety of larger liquid and less economically sensitive names during a downturn, so too will they likely return to the smaller end of the market to increase returns when rates and confidence turns. We would also like to note, with sadness and gratitude the passing of Charlie Munger who died in late November just shy of his 100th birthday. Charlie was the slightly less known of the Buffett/ Munger duo but undoubtedly an equal intellectual contributor to the investment advice and wisdom that has emanated forth from Berkshire Hathaway. Many of our investment team were drawn to investing after reading some of the intelligent and humorous advice from Buffett and Munger. We are grateful for his intellectual curiosity, humility and generosity of spirit in sharing his wisdom and life outlook with us. Thank-you Charlie.

*Buffett quips that you should never ask a barber if its time for a haircut because the answer is always "yes".

^Smalls = S&P-ASX Small Ordinaries Accumulation Index & Micros = S&P/ASX Emerging Companies Index

Fund Ratings

Zenith RECOMMENDED

Recommended Lonsec Research

Contact Us

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

Disclaimer

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