Spheria Australian Smaller Companies Fund

ARSN 117 083 762 | APIR WHT0008AU | mFund SPM02

Performance as at 31st August 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Fund[1]	3.9%	-0.2%	-9.6%	10.3%	9.1%	9.5%
Benchmark[2]	0.6%	-2.6%	-14.7%	4.1%	6.9%	6.4%
Difference	3.3%	2.4%	5.1%	6.2%	2.2%	3.2%

1 Spheria Australian Smaller Companies Fund. Returns of the Fund are net of applicable fees, costs and taxes.
2 Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.
3 Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2005. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

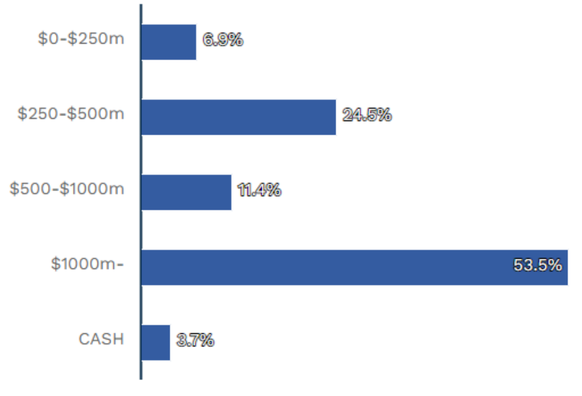
Overall Commentary

The Spheria Australian Smaller Companies Fund returned 3.9% (after fees) during the month of August, outperforming the ASX Small Ordinaries Accumulation Index by 3.3%.

Top 5 Holdings

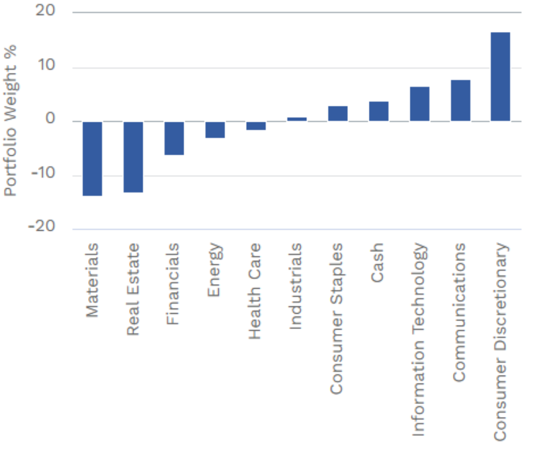
Company Name	% Portfolio
InvoCare Limited	5.3
Flight Centre Travel Group Limited	5.3
IRESS Limited	5.0
Monadelphous Group Limited	4.6
Michael Hill International Limited	4.4
Top 5	**24.5**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

The Fund performed well in August with results generally better than expected and takeover activity in the beaten-up technology sector aiding performance with a private equity group, Potentia Capital, conducting an off-market raid on Nitro Software (NTO), one of our key holdings at a significant premium to its last traded share price. The lithium sector continues to expand which has detracted from relative performance, but we note most of these miners are not producing, and the lithium price feels like it has gotten well ahead of fundamentals – this happened in 2019 as well. On the economic front, the combination of higher mortgage rates, higher fuel prices and rampant inflation has yet to significantly impact consumer spend with countervailing forces of full employment, strong wages growth and solid household balance sheets providing a buffer for now, and household credit still flowing. For what it's worth most of the companies we talk to are trading relatively well and balance sheets afford a solid buffer to ride out the highly anticipated economic downturn.

Major Contributors for the Month

Positive performance contributions from companies owned included:

Monadelphous (MND.ASX) – share price increased 27% after reporting a solid FY22 financial result in August. The balance sheet is sound with over $180m of net cash and the outlook for the business remains strong due to relatively high commodity prices. The Maintenance and Industrial services division grew revenues by 19% and now represents over 60% of group revenue. We view this transformation favourably as it is less risky than construction related revenue and more recurring in nature. MND is trading on an EV/EBIT multiple of about 10x.

Nitro Software (NTO.ASX) – jumped 37% after an off-market raid by a private equity firm, Potentia Capital, at $1.58 which was a significant premium to the undisturbed price. We partially sold into the raid for liquidity reasons but remain supporters of the company as we believe the product (PDF software) is excellent and the pivot in strategy to bring forward profitability (over growth) as sensible. This change in strategy clearly did not mesh well with some investors who sold the company down aggressively which has facilitated the opportunistic takeover approach. We feel Potentia Capital will need to substantially increase its offer to gain control of the company. At worst, if they decide not to, the offer highlights value in the asset and its broader strategic appeal.

Ht&E (HT1.ASX) – share price rallied 17% from a low base after reporting a solid 1H22 financial result. The radio industry continues to be a resilient advertising medium globally due to stable audiences with a growth angle into podcasting and digital platforms (e.g. HT1 owns the IHeart Radio licence in Australia). HT1's balance sheet is sound with less than $80m of net debt after extinguishing large tax liabilities during the period and acquiring the regional radio assets of Grant Broadcasting. Post balance date, HT1 will receive about $8.8m from the divestment of its final balance of Luxury Escape shares and has again put its 25% stake in Soprano up for sale, which could be worth upward of $75m. HT1 is trading on an EV/EBIT multiple of about 5x.

Major Detractors for the Month

Blackmores (BKL.ASX) – declined 11% after reporting a FY22 financial result that again exhibited little to no operating leverage. The company continues to grow its top line at a healthy rate (and has +$650m of sales) but cannot seem to contain costs resulting in profit margins well below that of sub-scale peers with somewhat lesser brands. For example, Vita Life Sciences (VLS) whose main brand is 'Herbs of Gold' has an EBIT margin of nearly 20% on a sales base of only +$60m. Given BKL's brand and scale we believe it should be generating EBIT margins of 20 to 40%, in line with larger peers like iNova and Swisse that are near the top end of that range. If we take the midpoint of 30% this would mean a tripling of BKL's earnings (currently 10% margins). The company has over $80m of net cash and trades on an EV/EBIT multiple of 18-20x with only modest margin expansion forecast.

Adbri (ABC.ASX) – fell 13% in August after a weak FY22 result with underlying earnings falling by about 15% due primarily to a lag in out-of-cycle pricing increases to recover inflationary pressures including pallets, shipping, labour, power, fuel and raw material prices. Demand does not appear to be a problem at this point in time with the outlook for cement, concrete and aggregates remaining robust due to strength in residential, infrastructure, commercial and mining sectors. Lime volumes are also stabilising with the potential for increased volume and tenure from their primary client who has been struggling with cost overruns in respect of their imported volumes. Lime pricing is also expected to improve. ABC's balance sheet is stretched due to the $300m Kwinana project upgrade, which is reason for some concern and means ABC is likely to trade below fair value due to the elevated financial risk.

Liontown Resources (LTR.ASX, Not Owned) – which we do not own rallied strongly (+31%) during the month and now has a market capitalisation of nearly $4bn, like many of its compadres in the small cap market. The company has no revenue but has begun construction of processing and facilities for its Kathleen Valley Lithium mine in WA. First production is expected in late FY24. We feel the Lithium price is trading well ahead of fundamentals and there are risks with investing in this kind of project given the timeline to production and large valuation already ascribed by the market.

Outlook & Strategy

Higher interest rates cleaned out pockets of hyper speculation in the small cap market this calendar year, however, there remains over-exuberance with many higher PE names still trading on crazy multiples and the lithium sector continuing its rapid ascent but with very few (if any) of the miners producing yet. Recent M&A activity in bombed out small cap technology names that are losing money including Nearmap and more recently Tyro Payments seems to be reflating that segment of the market. This could be a difficult environment for us to perform on a relative basis particularly if cash burners find favour again. Nonetheless, we think the broader market sell-off presents a great opportunity for longer term alpha generation with valuation multiples pricing in a very dire economic scenario.

Platform Availability List

If a fund is not available on your preferred platform, please contact us. Please check with your platform for minimum investment requirements and fees.

- AMP North
- Asgard
- BT Panorama
- CFS FirstWrap
- DPM
- FNZ Group
- HUB24
- IOOF eXpand
- IOOF Wrap
- Macquarie Wrap
- Mason Stevens
- MLC Navigator
- MLC Wrap
- MLC Wealth Administration
- Netwealth
- OneVue
- PowerWrap
- Praemium
- Premium Choice
- SimpleWrap
- Wealth02 uXchange

Spheria Australian Smaller Companies Fund	
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Investment Objective	Outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term
Investing Universe	Primarily listed companies outside the top ASX 100 listed companies by market capitalisation and companies listed on the New Zealand Stock Exchange with an equivalent market capitalisation
Holdings	Generally 20-65 stocks
Distributions	Half-Yearly
Fees	1.10% p.a. Management fee & 20% performance fee of the Fund’s excess return versus its benchmark, net of management fee.
Cash	Up to 20% cash, typically 5% - 10%
Expected Turnover	30% - 40%
Style	Long only
APIR	WHT0008AU
Minimum Initial Investment	$25,000

Fund Ratings

Zenith HIGHLY RECOMMENDED

Recommended Lonsec Research

Further Information

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

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Link to the Target Market Determination
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