Spheria Australian Smaller Companies Fund

ARSN 117 083 762 APIR WHT0008AU

Performance as at 30 September 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Fund[1]	-9.4%	0.4%	-17.4%	5.2%	6.7%	7.7%
Benchmark[2]	-11.2%	-0.5%	-22.6%	-0.8%	4.1%	4.3%
Difference	1.8%	0.8%	5.1%	6.0%	2.7%	3.4%

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.

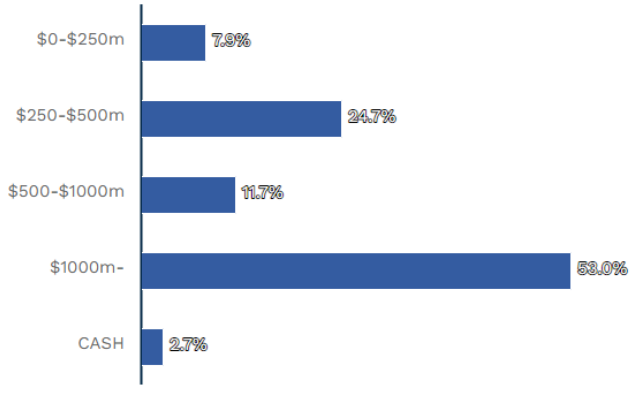
Overall Commentary

The Spheria Australian Smaller Companies Fund returned -9.4% (after fees) during the month of September, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 1.8%.

Top 5 Holdings

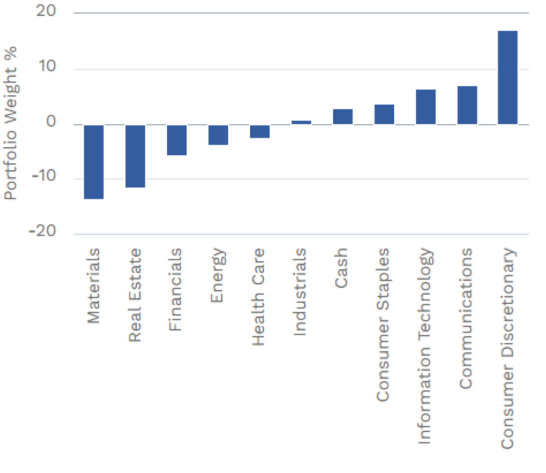
Company Name	% Portfolio
InvoCare Limited	5.3
Michael Hill International Limited	5.0
Monadelphous Group Limited	4.9
Flight Centre Travel Group Limited	4.5
IRESS Limited	4.3
Top 5	**24.0**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

Markets struggled over September after the respite in July and August. The Small Ordinaries Accumulation Index declined over 11% with the Mid-Small Index marginally less impacted falling 9.0%. Globally markets were also well down over the month. Bond yields rose in the US and more modestly in Australia such that 10-year yields are now close to 4% in both countries. Other world political events haven't calmed investors nerves either with energy prices re-asserting themselves and a great deal of angst present with companies we have spoken to around rising energy prices for consumers.

Having said this, we have to acknowledge that markets are now down broadly 20-25% year to date with smaller and microcaps worse affected than Australian large caps. A lot of the present risks are known to some extent – inflation, rising rates, high energy prices and macro uncertainty around the Ukrainian situation. The extreme outliers in smaller companies – the large pockets of overvaluation in speculative growth names – have largely come back down to earth. During September for example several smaller company names were suspended and subsequently removed from indices. These stocks included AVZ Minerals (AVZ.ASX), BWX (BWX.ASX) and Firefox (FFX.ASX) which in aggregate represented close to 1.2% of the small cap index. Investors are now talking about valuation and discount rates again and a more sensible economic lens is being used to allocate capital. Whilst the macro environment continues to present risks, it is worth remembering that fortune favours the intelligently brave and much better opportunities appear at times like these than when there is a positive consensus around buying an over-promoted growth market.

With that in mind, and a degree of conservatism in our forecasts, we continue to look for the best opportunities across the market and to try to sensibly rotate our portfolios into opportunities that we either thought were too expensive before and / or had material earnings risks.

Major Contributors for the Month

Positive performance contributions from companies owned included:

Michael Hill International (MHJ.ASX) – rose 7.5% in September, in contrast to the broader market which fell during the month. MHJ announced their annual results at the end of August and as has been the trend for the last two years, continue to drive earnings growth ahead of revenue, seeing margins expand. Despite a significant number of store days being lost due to COVID-19 lockdowns at the start of the financial year, group revenue grew 7% and EBIT grew 11.1%. This was driven by continued store productivity, growth in digital, and a 76% growth in loyalty members. The balance sheet finished the financial year with ~$96m of net cash and as such the company announced a share buy-back of up to 5% of the company's issued capital to deliver further earnings accretion to long term shareholders. Despite the impressive results and strong balance sheet, the company is trading on ~4x EV/EBIT and yielding over 7%.

Monadelphous (MND.ASX) – share price increased 1.1% in September, continuing to trend higher after a solid return in August after the company announced their FY22 results. As discussed in the last commentary, 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. We consider Monadelphous as one of the highest quality mining services businesses in Australia and is a second order beneficiary of the capex mining cycle. The stock has $180m of net cash and trading on an EV/EBIT multiple of around 10x.

Nitro Software (NTO.ASX) – remained flat over the month but outperformed as the market fell in September. As discussed in last month's commentary, NTO received an off-market offer by a private equity firm Potentia Capital at $1.58 which saw the share price hover around these levels over the month. Despite Nitro rejecting the Indicative Proposal on the belief the offer undervalues the company investors will await to see if another bid is proposed. We continue to remain supporters of the company as we believe the product (PDF productivity and e signing software) is excellent, the client base is strong, and the product retention is high. We are supportive of NTO's earlier pivot to profitability and positive cashflow over high revenue growth at disproportionate cost. Our sense is the current offer is too low given the recurring nature of most of the company's revenue, the growth potential and a well-funded balance sheet. At an EV/Sales multiple of around 4x it remains lowly priced for a global growing SaaS business.

Major Detractors for the Month

Iress (IRE.ASX) – fell 21% in September as the company downgraded guidance at the end of the month. The announcement came as a surprise to the market, as the company had only confirmed guidance six weeks earlier when they announced their 1H22 result. The company's NPAT is expected to be in the range of $54-$58m, which is a 17% downgrade to the midpoint of their original guidance in August. The company flagged macro conditions, delays to conversion of new sales opportunities and higher technology costs driven by the US Dollar strength as the drivers of the downgrade. Whilst the announcement was disappointing, we feel the impacts are temporary with macro headwinds causing a lengthening of the sales pipeline and increased costs likely to normalise in the medium term as inflation eases. The contra to the earnings downgrade was the announcement that Iress had secured a new agreement with Commonwealth Superannuation Corporation to adopt Iress software, Acurity, for the administration of the defined benefit scheme members. We feel this is a positive and endorses the strength of the Iress product and technology. IRE is now trading on ~15x FY23 EV/EBIT, for a SaaS business with sticky recurring revenue.

Flight Centre (FLT.ASX) – fell 20% in September on no news. We believe the share price movement over the month was more a reflection of the macroeconomic environment than stock fundamentals. Consumer discretionary names over the last few months have been heavily impacted on the view that higher interest rates and inflation will crimp consumer spending. Whilst we do agree than some consumer discretionary names, particularly those that benefited from COVID-19, may come under pressure we don't feel the same applies to travel. Consumers have been unable to travel for over two years because of COVID-19 and pent-up demand is extremely strong. As Flight Centre announced at their full year result in August, corporate travel TTV is now trading above pre-COVID and leisure close to 70% of pre-COVID levels. As most economies (except for China) are now open we see the consumers wallet being over indexed to travel and FLT being a key beneficiary of this. The business has now been generating positive cash flow since March 2022 and is trading on ~8x pre-COVID EV/cash EBIT.

New Hope Coal (NHC.ASX, Not Owned) – which rallied strongly (+28%) during the month following the release of their FY22 result. Similar to other coal names, NHC has benefited from the record coal prices in the last 12 months, with the company recording record earnings and cash flow as a result. The industry has been underinvested and has seen coal companies like NHC benefit from this. We have avoided owning names like New Hope Coal due to ESG concerns and at this stage of the cycle are weary of jumping into names where commodity prices are at all-time highs and any reversal could see shares linked to the commodity fall too.

Outlook & Strategy

It's always hard to be positive when you are sitting in a morass of negativity about markets. However, most great investors have made money betting against a fearful crowd. Over time it's been proven that it's hard to time markets as we are overly prone to emotion and secondly that there have been few places to invest that have out earned the market as an asset class. Whilst there are many likely negatives it's worth remembering that we are buying individual businesses with, in some cases, innovative and adaptive management teams who have dealt with challenging environments before. We also need to keep in mind that a lot of the de-rating of reasonable companies has now put many of the companies we own on low to mid-single digit EV/EBIT multiples. Couple this with bullet proof balance sheets and we feel comfortable that returns will reward investors over time. Finally, there is some evidence that the pent-up inflationary forces we are dealing with could abate somewhat which may ease the rise of longer-term interest rates providing the market with some respite in time.

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

Spheria Australian Smaller Companies Fund

ARSN 117 083 762 | APIR WHT0008AU | mFund SPM02

Fund Ratings

Further Information

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

Disclaimer

This communication is prepared by Spheria Asset Management Pty Limited ('Spheria') (ABN 42 611 081 326, Corporate Authorised Representative No. 1240979) as the investment manager of the Spheria Australian Smaller Companies Fund (ARSN 117 083 762) (the 'Fund'). Pinnacle Fund Services Limited ('PFSL') (ABN 29 082 494 362, AFSL 238371) is the product issuer of the Funds. PFSL is not licensed to provide financial product advice. PFSL is a wholly-owned subsidiary of the Pinnacle Investment Management Group Limited ('Pinnacle') (ABN 22 100 325 184). The Product Disclosure Statement ('PDS') and Target Market Determination ('TMD') of the Fund are available via the links below. Any potential investor should consider the PDS and TMD before deciding whether to acquire, or continue to hold units in, the Fund.
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
This communication is for general information only. It is not intended as a securities recommendation or statement of opinion intended to influence a person or persons in making a decision in relation to investment. It has been prepared without taking account of any person's objectives, financial situation or needs. Any persons relying on this information should obtain professional advice before doing so. Past performance is for illustrative purposes only and is not indicative of future performance. Unless otherwise specified, all amounts are in Australian Dollars (AUD).
Whilst Spheria, PFSL and Pinnacle believe the information contained in this communication is reliable, no warranty is given as to its accuracy, reliability or completeness and persons relying on this information do so at their own risk. Subject to any liability which cannot be excluded under the relevant laws, Spheria, PFSL and Pinnacle disclaim all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage), however caused, which may be suffered or arise directly or indirectly in respect of such information. This disclaimer extends to any entity that may distribute this communication.
Any opinions and forecasts reflect the judgment and assumptions of Spheria and its representatives on the basis of information available as at the date of publication and may later change without notice. Any projections contained in this presentation are estimates only and may not be realised in the future. Unauthorised use, copying, distribution, replication, posting, transmitting, publication, display, or reproduction in whole or in part of the information contained in this communication is prohibited without obtaining prior written permission from Spheria. Pinnacle and its associates may have interests in financial products and may receive fees from companies referred to during this communication.
This may contain the trade names or trademarks of various third parties, and if so, any such use is solely for illustrative purposes only. All product and company names are trademarks™ or registered® trademarks of their respective holders. Use of them does not imply any affiliation with, endorsement by, or association of any kind between them and Spheria.
Zenith Disclaimer: The Zenith Investment Partners ('Zenith') (ABN 27 103 132 672, AFSL 226872) rating (assigned Spheria Australian Smaller Companies Fund – February 2022) referred to in this piece is limited to "General Advice" (s766B Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual, including target markets of financial products, where applicable, and is subject to change at any time without prior notice. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of, and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Past performance is not an indication of future performance. Zenith usually charges the product issuer, fund manager or related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at https://www.zenithpartners.com.au/our-solutions/investment-research/fund-research-regulatory-guidelines/.
Lonsec Disclaimer: The Lonsec rating (assigned as follows: Spheria Australian Smaller Companies Fund October 2021) presented in this document is published by Lonsec Research Pty Ltd ('Lonsec') (ABN 11 151 658 561, AFSL 421445). The Rating is limited to "General Advice" (as defined in the Corporations Act 2001 (Cth)) and based solely on consideration of the investment merits of the financial products. Past performance information is for illustrative purposes only and is not indicative of future performance. They are not a recommendation to purchase, sell or hold Affiliate Name products, and you should seek independent financial advice before investing in these products. The Ratings are subject to change without notice and Lonsec assumes no obligation to update the relevant documents following publication. Lonsec receives a fee from the Fund Manager for researching the products using comprehensive and objective criteria. For further information regarding Lonsec's Ratings methodology, please refer to our website at: https://www.lonsec.com.au/investment-product-ratings/.