# Spheria Australian Microcap Fund

ARSN 611 819 651 | APIR WHT0066AU | mFund SPM01

## Performance as 30 November 2022

| | 1 Month | 3 Months | 1 Year | 3 Years p.a. | 5 Years p.a. | Inception p.a[1] |
|---|---|---|---|---|---|---|
| Fund[2] | 2.2% | 0.5% | -3.9% | 16.9% | 12.0% | 14.0% |
| Benchmark[3] | 4.9% | -0.8% | -14.0% | 2.6% | 4.4% | 6.6% |
| Difference | -2.7% | 1.3% | 10.1% | 14.3% | 7.6% | 7.4% |
| Microcap Index[a] | 3.3% | -4.1% | -16.2% | 12.9% | 10.3% | 11.0% |

[1] Inception date is 16 May 2016. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.
[2] Spheria Australian Microcap Fund. Returns of the Fund are net of applicable fees, costs, and taxes.
[3] Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.
[a] Microcap Index refers to S&P/ASX Emerging Companies Accumulation Index.

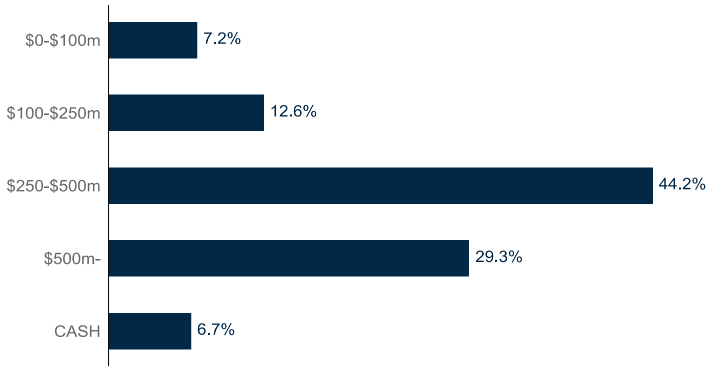
## Overall Commentary

The Spheria Australian Microcap Fund returned 2.2% (after fees) during the month of November, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 2.7%.

## Top 5 Holdings

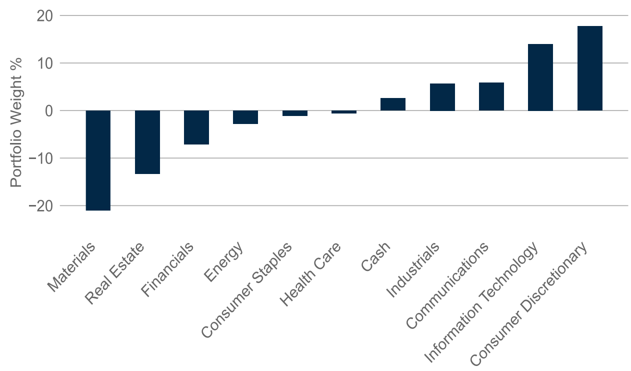
| Company Name | % Portfolio |
|---|---|
| Nitro Software Limited | 5.0 |
| Supply Network Limited | 4.8 |
| Ainsworth Game Technology Limited | 4.8 |
| Michael Hill International Limited | 4.3 |
| Appen Limited | 4.2 |
| **Top 5** | **23.1** |

## Market Cap Bands




Source: Spheria Asset Management

## Active Sector Exposure




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 for the month**

Positive performance contributions from companies owned included:

**Ainsworth Game Technology (AGI.ASX)** – rose 58% in November after 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 FY 21. 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.

**Ardent Leisure (ALG.ASX)** – rose 21% in November after the company provided a trading update at its 2022 AGM. The company announced 1Q23 revenue for Theme Parks and Attractions rose 154% on pcp and the highest Q1 revenue seen since the Thunder River Rapids Ride accident in FY17. Dreamworld also achieved its first positive EBITDA quarter since the tragedy, predominately through increased ticketing yields. The business recently sold its Main Event business for US$835m (AU$957m) with a deferred consideration of up to US$14.8m. Subsequent to the FY22 end, the business has been notified it will receive US$9m (~AU$13.3m) proceeds from working capital adjustments. We bought the company in October as the business had net cash of $163.5m and deferred tax benefit of ~$52m, with the market therefore ascribing ~$30m value to Dreamworld and SkyPoint. We feel the land value alone before ascribing any value to the Dreamworld franchise well exceeded this.

**Major Detractors for the month**

**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).

**Helloworld Travel (HLO.ASX)** – fell over 23% in November, after the company announced that Qantas had sold its shareholding in the Company. Qantas has been a shareholder in HLO and its predecessor businesses since 2008 and given they owned over 12% of HLO the sale expands the free float of the business. Given the sell down, Andrew Finch, General Counsel and Group Executive, Office of the CEO of Qantas resigned from the board. Late in the month the company provided a trading update and appointment of a new Director. Revenue and EBITDA continued to trend higher, with EBITDA of $3.2m in October compared to $5.3m for Q1 2023 and revenue increasing 180% YTD. The balance sheet remains pristine with $90m of net cash (excluding client money) and a stake in Corporate Travel (CTD.ASX) worth $50m leaving the business with an ev of just $71m. Assuming travel continues to recover we think HLO could well be trading on circa 2x sustainable 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**

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.

**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

| | | | |
|---|---|---|---|
| Aegis | FNZ Group | MLC Navigator | PowerWrap |
| Asgard | HUB24 | MLC Wrap | Praemium |
| BT Panorama | IOOF eXpand | Netwealth | Premium Choice |
| DPM | Macquarie Wrap | OneVue | Wealth02 uXchange |

| **Spheria Australian Microcap Fund** | |
|---|---|
| Benchmark | S&P/ASX Small Ordinaries Accumulation Index |
| Investment Objective | The Funds aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term |
| Investing Universe | Primarily listed companies outside the top ASX 250 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 | Annually |
| Fees | 1.35% p.a management fee & 20% performance fee of the Fund’s excess return versus its benchmark, net of the management fee |
| Cash | Up to 20% cash, typically 5% - 10% |
| Expected Turnover | 20% - 40% |
| Style | Long only |
| APIR | WHT0066AU |
| Minimum Initial Investment | $25,000 |

# Spheria Australian Microcap Fund

ARSN 611 819 651 | APIR WHT0066AU | mFund SPM01

### Fund Ratings

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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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