Spheria Australian Microcap Fund

ARSN 611 819 651 | APIR WHT0066AU | mFund SPM01

Performance as at 30 June 2023

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[1]
Fund[2]	0.7%	1.6%	12.4%	27.9%	11.4%	12.8%
Benchmark[3]	0.0%	-0.5%	8.4%	5.2%	2.3%	5.7%
Difference	0.7%	2.1%	4.0%	22.8%	9.2%	7.1%
Microcap Index[a]	2.6%	-2.5%	7.4%	16.6%	8.6%	9.5%

[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.

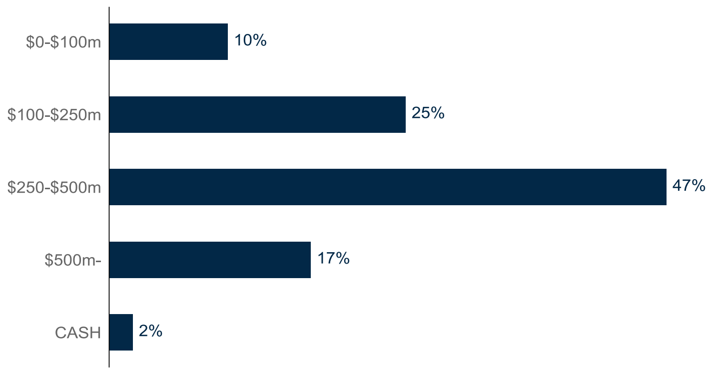
Overall Commentary

The Spheria Australian Microcap Fund returned 0.7% (after fees) for the month of June, outperforming the S&P-ASX Small Ordinaries Accumulation Index by 0.7%.

Top 5 Holdings

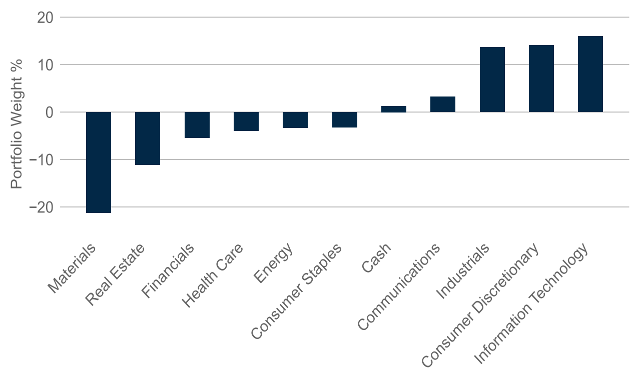
Company Name	% Portfolio
Vista Group International Limited	5.6
Supply Network Limited	5.3
Bravura Solutions Limited	5.0
Mader Group Limited	4.6
Alliance Aviation Services Limited	4.4
Top 5	**24.8**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

Sharemarket returns were broadly stronger for global markets. Closer to home the Australian Small Ordinaries index was weighed down by tax loss selling into financial year end. The Financials and Energy sectors led the charge as Materials and Consumer Discretionary weighed on the benchmark. Investors are being challenged by mixed signalling from the RBA and conflicting economic data, as well as the market's seemingly schizophrenic response, whereby good economic news is interpreted as bad news for markets in one breath and vice versa in the next. As the market fixates on these short-term gyrations, we seek to exploit them by remaining disciplined and positioning for the long term instead of reacting to noise.

The flurry of corporate activity at the smaller end of the market continued through the month of June with Fanatics trumping Draftkings' bid for Pointsbet's US business, ARN Media raiding Southern Cross Media for 14.8% of the register and at the pointier end of the market, Limeade receiving a bid at an incredible 325% premium to the last traded price. Interestingly, it appears that investor risk appetite is increasing with M&A activity heating up again at the cash burning end of the market. We've also seen fresh capital come to market as Redox (a $1.2bn chemical distribution business) managed to find enough support in a high interest rate environment to make it the largest Initial Public Offering of 2023. We continue to avoid the allure of "shiny new toys" preferring to own businesses with more transparent and longer track records to analyse.

During the month, the fund added to positions in GWA Group (GWA.ASX), Pointsbet Holdings (PBH.ASX), Alliance Aviation Services (AQZ.ASX) and Dexus Convenience Retail REIT (DXC.ASX) on valuation. The fund took profits in Mader Group (MAD.ASX), Helloworld Travel (HLO.ASX) and Appen (APX.ASX) and exited Monash IVF Group.

Major Contributors to Performance

Over the month the largest contributors to performance were from overweight positions in VGL.ASX (122bps), PBH.ASX (67bps), SNL.ASX (38bps), and PPS.ASX (34bps).

Pointsbet Holdings (67bps)

Bidding tension for Pointsbet's US business emerged during the month with US giant Draftkings submitting a non-binding indicative proposal of US$195m (30% premium) to Fanatics original proposal of US$150m, though Fanatics was quick to fire back increasing the offer to $225m (a 50% premium to what was originally offered). Spheria originally purchased Pointsbet on the announcement of the sale of the US business, which has been cash-burning for several years in pursuit of market share gains in a highly competitive market against players with far deeper pockets. The board expects to now pay out a distribution of up to $1.44 upon completion versus Pointsbets share price of $1.79 at 30 June 2023.

Shareholders will be left with the Australian business which is now breakeven on an annual basis which the market is valuing at ~$100m (including ~$30m of cash), plus the Canadian business. The Australian business (on a standalone basis) trades on <0.5x revenue and is at an inflection point with cashflows turning positive. We believe shareholders are materially underestimating the value of the Pointsbet Australian and Canadian businesses and are overstating the risk to the business from proposed regulations concerning online gambling promotions that were announced last month. With the likes of Betr and Ladbrokes previously looking at the Australian assets, there is clearly some risk that the remaining operations are mopped up by a larger competitor.

Major Detractors from Performance

The largest detractors from performance included overweight positions in APX.ASX (-80bps) following a pull-back after touching a multi-year high earlier in the month, ABY.ASX (-69bps), MCP.ASX (-49bps) and AQZ.ASX (-33bps) as well as underweight positions in PDN.ASX (-22bps) and AUB.ASX (-16bps).

Appen (-80bps)

Appen more than doubled post the recent capital raise (peaking in the first week of June) and has since given back some of the return as investors take profits. Global AI has gained a lot of attention of late, with investors (and speculators!) on the lookout for the next Nvidia. There are not many ways to get leverage to AI in the Australian listed market outside of Appen and with a refreshed management team already making inroads as demonstrated at the investor day in May we are confident of what lies ahead for this business. Appen is well placed to benefit from the growth in generative AI which requires human input, particularly as it relates to ensuring the accuracy of the outputs. Appen has been pivoting towards Large Language Model (LLM) type work with the expectation that this market will grow to more than $100bn by 2030. The recent capital raise provides ample funds to invest in the growth of the business for the next couple of years. A substantial US$300m of revenue (admittedly vs a peak of around >US$400m) alongside a re-engineered cost base will mean the business achieves profitability in the short to medium term. On a price to revenue metric the company is trading on less than 1x. Assuming the business can generate 10% EBIT margins (not a stretch in our view) it would be generating US$30m of EBIT and trading on a modest 10x EV/EBIT. As a reminder this stock once traded above $40 a share!

Outlook & Strategy Going Forward

We remain constructive on markets and continue to see strong valuation support, in particular at the smaller end. We remain fully invested and are finding an abundance of opportunities in under-owned pockets of the market including the consumer discretionary space, where true value has emerged as investors focus far too much on the next earnings print and are seemingly discounting quality businesses like Universal Store Holdings and Michael Hill International which have strong free cash flow and return profiles, a proven ability to ride out market cycles, and are further supported by strong balance sheets.

With the dislocation between value and price in small companies at historic highs, we expect M&A activity to ramp up even further over the next 6 - 12 months. Strategic buyers and private equity alike have a demonstrated propensity to take advantage of depressed valuations and a willingness to take a longer-term view than many other market participants. This is but one way that value ultimately gets realised, supporting our conviction that remaining true to our investment process will deliver just rewards.

In recent times we have witnessed a huge asset allocation away from equities and fund manager's hoarding cash, all in anticipation of a "buy the correction moment". This has helped to drive a wedge between large and smaller cap performance, in our view. But with the Australian population set to grow strongly next year due to decade high levels of migration and superannuation contribution rates increasing to 12% from July 2025, a peak in interest rates could see an epic wall of capital flood back into equities, a backdrop that is almost certain to see smaller companies outperform.

Last quarter's dramatic move to the upside in the beaten-up tech sector serves as reminder of just how rapid these moves can be and that almost by necessity they tend to be led by areas of the market that have been neglected. It is in these neglected parts of the market where we focus our efforts and tend to find our best ideas.

Platform Availability List

The Spheria Australian Microcap Fund is available on the below platforms. Platforms provide investors with consolidated and centralised reporting (including administration, tax, and distribution) by bundling together a range of managed funds as one single product

Asgard	HUB24	MLC Navigator	PowerWrap
BT Panorama	Insignia eXpand	MLC Wrap	Praemium
DASH	IOOF Portfolio Service	Netwealth	Premium Choice
DPM	Macquarie Wrap	OneVue	Xplore Wrap

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

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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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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