Spheria Australian Smaller Companies Fund

ARSN 117 083 762 | APIR WHT0008AU | mFund SPM02

# Performance as 31 December 2022

| | 1 Month | 3 Months | 1 Year | 3 Years p.a. | 5 Years p.a. | Inception p.a[1] |
|---|---|---|---|---|---|---|
| Fund[2] | -2.9% | 3.4% | -16.9% | 5.3% | 5.4% | 7.9% |
| Benchmark[3] | -3.7% | 7.5% | -18.4% | 1.4% | 2.9% | 5.3% |
| Difference | 0.8% | -4.1% | 1.5% | 4.0% | 2.5% | 2.7% |

[1] Inception date is 11 July 2016. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.
[2] Spheria Australian Smaller Companies Fund. Returns of the Fund are net of applicable fees, costs, and taxes.
[3] Benchmark is the S&P/ASX Small Ordinaries Accumulation Index.

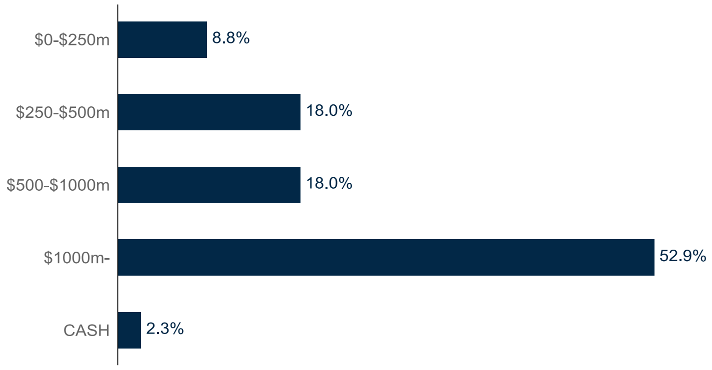
## Overall Commentary

The Spheria Australian Smaller Companies Fund returned -2.9% (after fees) during the month of December, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.8%.

## Top 5 Holdings

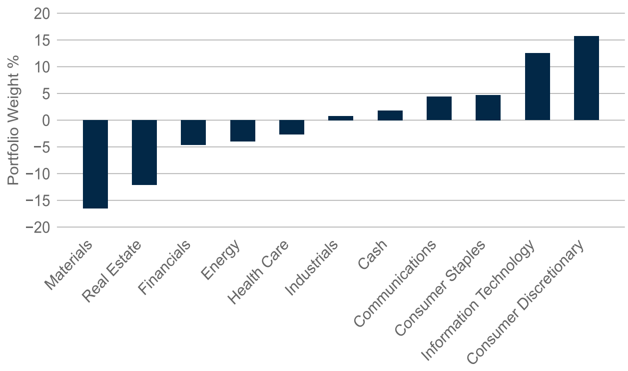
| Company Name | % Portfolio |
|---|---|
| IRESS Limited | 5.2 |
| InvoCare Limited | 4.9 |
| Nitro Software Limited | 4.8 |
| Flight Centre Travel Group Limited | 4.7 |
| Blackmores Limited | 4.5 |
| **Top 5** | **24.0** |

## Market Cap Bands




Source: Spheria Asset Management

## Active Sector Exposure




Source: Spheria Asset Management

# Markets

The benchmark fell nearly 4% in December erasing most of the large gain made in November. A perfect storm of negative macro-economic factors continues to pummel asset prices with market participants praying for relief from Central Banks that are fixated with reining in rampant inflation (which they created mind you) by snuffing demand. Monetary policy is a blunt instrument – it will work in time – and we are beginning to see the impacts in the real world with a number of companies in various sectors downgrading profit expectations in the last few months. With a lot of negativity baked into valuations particularly at the "value" end of the market we feel the risk reward scenario is favourably skewed for long term investors, particularly if interest rates have peaked which feels likely given the unprecedented nature of the tightening in terms of speed and overall magnitude of increases relative to high levels of household debt.

**Major Contributors to Performance**

Positive performance contributions from companies owned included:

**Bega Cheese (BGA.ASX)** – rose almost 11% outperforming the broader market on no news. We have recently discussed some of the headwinds that have been facing Bega including higher farmgate milk prices, elevated competition amongst dairy processors and higher costs arising from weather and COVID-19 absenteeism. In November it was revealed that one of Bega's largest competitors, Saputo would be closing their Australian plants taking approximately 15-20% of capacity out of the market. We view this as good news as there has been too much processing capacity compared to milk supply resulting in companies like Bega having to bid aggressively to secure milk. Despite the recent firming of the share price, we believe the company remains undervalued given the market is capitalising the challenged (bottom of the cycle) environment that Bega currently finds itself. As raw material cost pressures eventually abate, we expect a substantial recovery in the earnings base.

**Nitro Software (NTO.ASX)** – gained 5% outperforming the broader market as the bidding war between Alludo and Potentia carried over to December. We have discussed NTO in several commentaries after the company received proposals at $1.58 and later $1.80 from Potentia, followed by a $2 Board recommended offer from Alludo (a software company owned by KKR) in November. In December, Potentia matched the $2 bid, however, this was quickly countered by Alludo with an increase to $2.15. Post month end, both parties have lodged applications to the Takeover Panel alleging shortcomings in the opposite camp's takeover offers. The share price is trading at a slight premium to the highest bid from Alludo on the expectation that Potentia raises its offer to $2.15 or higher thus escalating the battle for control.

**Universal (UNI.ASX)** – rose over 3% in December on no obvious news. The company provided a trading update in November which revealed sales (excluding TRILLS, a recent acquisition) were up 40.2% vs the prior corresponding period. Noting the comparison in the prior period was impacted by lockdowns in NSW and Victoria the result was still positive in the current environment with many fearing a significant slowdown in consumer spending. Another positive was that YTD gross margins have improved which is in somewhat of a contrast to several other retailers locally and abroad which have seen gross margins fall recently as they look to discount to clear stock. Consistent with our investment thesis on UNI they have prided themselves on avoiding heavy discounting to maintain their brand perception and support gross margins. Whilst we acknowledge FY23 may be a challenging year for many retailers as higher inflation and interest rates potentially impact the consumer, we feel UNI is well placed to weather any slowdown. Their target customer is 18-24 years of age and tend to have more disposable income as they are less exposed to mortgages. UNI has a net cash balance sheet and is trading on ~7x EV/EBIT.

**Major Detractors from Performance**

**City Chic Collective (CCX.ASX)** – continued to fall in December after the company provided another weak trading update with global YTD revenue (as at 18 December 2022) down 7% vs the prior period due to weaker than expected Black Friday/Cyber Monday sales. The weaker retail environment and excess inventory position has forced increased promotional activity which has resulted in further gross margin compression. The company is now expecting a small loss in 1H23. We do not expect this equation to improve in the short to medium term as the company works through elevated inventory. Of greater importance at this point is liquidity and transitioning the balance sheet from a net debt to net cash position which unfortunately is at the expense of group profitability. We are taking a longer-term view on this company and will support the business in the event of a capital call.

**Ainsworth Gaming (AGI.ASX)** – fell almost 18% in December on no news. As discussed in last month's commentary AGI was one of the top contributors with the share price rallying 58% after the company revealed they expected 1H23 PBT to be approximately $18m compared to the $10m earned in 1H22, a significant increase from losses experienced in 2021. 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) and Florida (+$10m). The business is trading on about 6-7x EV/EBIT and is returning to growth under a new management team.

**Flight Centre (FLT.ASX)** – fell 10% in December in sympathy with the global travel complex. In November, the company provided a trading update at its 2022 AGM which was weaker than expected given the incredible rebound in Total Transaction Values (TTV). The company has cut its full-time staff numbers by nearly half that of pre-COVID levels and reduced its store lease costs by one-third. With TTV now approaching 90% of pre-COVID levels – albeit at lower margins – we believe earnings can still outpace market expectations given the significant cost out in conjunction with travel spend which we believe will materially over-index in spite of a potentially weaker economic backdrop. Trading on ~7x normalised EV/EBIT we feel FLT offers significant value as people catch up on almost 3 years of restricted travel.

**Outlook & Strategy Going Forward**

We are highly constructive on valuations for the companies in our portfolio and for the majority their financial strength, where there is balance sheet risk – for example CCX – we believe the position size appropriate given the range of scenarios. These factors provide us comfort that we are in a strong position to navigate a complex and an extremely challenging economic environment.

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**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 | HUB24 | MLC Navigator | PowerWrap |
| Asgard | IOOF eXpand | MLC Wrap | Praemium |
| BT Panorama | IOOF Wrap | MLC Wealth Administration | Premium Choice |
| CFS FirstWrap | Macquarie Wrap | Netwealth | SimpleWrap |
| DPM | Mason Stevens | OneVue | Weath02 uXchange |
| FNZ Group | | | |

| **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 the 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

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## Fund Ratings

## Fund Ratings

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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