Spheria Global Microcap Fund

ARSN 627 330 287 | APIR WHT6704AU

Performance as at 30th June 2022

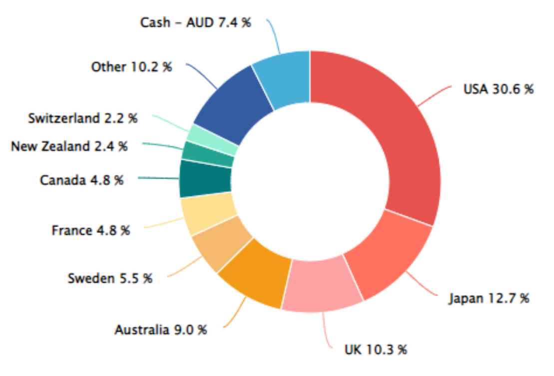
	1 Month	3 Months	1 Year	3 Years p.a.[3]	Inception p.a[3]
Fund[1]	-6.6%	-13.2%	-19.4%	8.4%	9.6%
Benchmark[2]	-5.3%	-10.0%	-18.7%	9.1%	8.6%
Difference	-1.3%	-3.2%	-0.7%	-0.7%	1.0%

1 Spheria Global Microcap Fund. Returns of the Fund are net of applicable fees, costs and taxes.
2 Benchmark is the MSCI World Microcap Index in AUD (Net) from 1 July 2021 and prior to that MSCI Kokusai (World Ex-Japan) Microcap Index in AUD.
3 Inception date is 1 March 2019. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

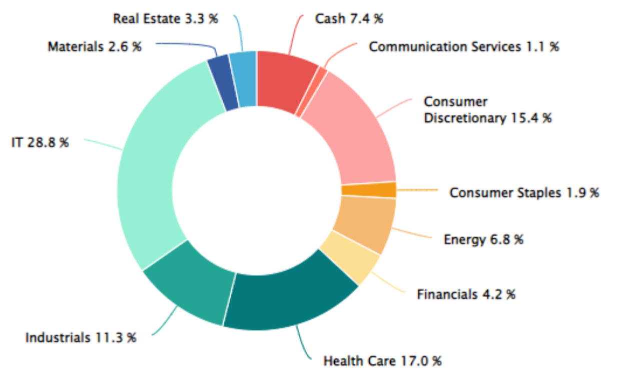
Overall Commentary

The Spheria Global Microcap Fund returned -6.6% (after fees) during the month of June, underperforming the MSCI World Microcap Index by 1.3%.

Regional Exposure



Sector Exposure



Source: Spheria Asset Management

Global Characteristics

	Average Mcap (USD)	EPS Growth (%)	Trailing FCF Yield (%)	Dividend Yield (%)	Net Debt / EBITDA	FCF Conversion (%)
Spheria	978	14.3	7.3	6.4	-1.0	94.1
World Micro	148	-9.4	0.2	3.0	0.9	65.9
World Smalls	1,940	5.0	3.3	2.5	2.0	70.4
S&P500	71,273	15.6	4.8	1.5	0.9	92.2
Nasdaq	5,720	10.5	3.9	0.8	0.3	95.0

EPS= Earnings per Share, FCF = Free Cash Flow, Negative Net Debt / EBITDA figures show a debt free, or net cash balance sheet.

Markets

Global sharemarkets continued their sell-off into June, as central banks continued to raise interest rates to counter inflationary pressures thus leading to a reassessment of risk and therein market prices for all asset classes. It's simple economics when demand is too strong relative to supply you get higher prices ("inflation") hence the need for central banks to raise interest rates to curtail demand. Unfortunately, central banks were far too accommodating for too long during the COVID-19 spell and the expectation is they are now likely to over-react the other way for too long. Markets do not like higher interest rates and the level of indebtedness across economies is alarming both in the context of government and households, thus servicing the interest bill will likely crimp demand via higher taxes and lower disposable income. Hence, the broad-based sell-off in sharemarkets and the more pronounced hit to consumer discretionary sectors and long duration assets – particularly those that are cash burning.

We believe the "washout" has offered up significant opportunities from a valuation perspective and have used this window to rotate into new ideas where we believe the risk-reward is skewed in our favour, this includes companies that are exposed to consumer spending including Zillow (Z.US), Sonos (SONO.US) and Burberry (BRBY.UK). In the case of Zillow, it's housing sales in the USA given it is the number one property portal in that market by a large margin (3x audience of next largest competitor), whilst Sonos sells higher end integrated speakers for household use, and Burberry is an up-market fashion retailer undergoing a revitalization. The common feature that de-risks all three investments is their balance sheet strength. Zillow has approximately US$1.7bn, Sonos US$600m and Burberry £900m of net cash.

The re-engineering of the portfolio means we are moving up the market capitalisation curve, which we believe is in the best interests of clients at this juncture given the breadth of opportunities at this point of the market cycle.

Major Contributors for the Month

BML (4694.JP) – share price continued to rally in June making it the largest contributor to performance. BML is the second largest player in the Japanese pathology market with a leading position in routine testing for general practitioners. The company also competes with Hospital labs who are under pressure for volume as Japan transitions to more treatment in the community setting. BML's focus on high volume general testing for smaller clinics, including regional areas has thus underpinned solid growth in volumes and its large central lab provides a competitive advantage which has underwritten stable margins over time. BML also has been a significant beneficiary from COVID testing in recent years, however, we forecast this to abate. Excluding this we have BML trading on 3x EV/EBIT and it has A$1bn of net cash on its balance sheet.

Zynex (ZYXI.US) – continued to bounce in June with the share price up a further 10%. The company is capitalising on the demise of its two much larger competitors who were investigated by the DOJ in 2016 for mis-selling products and were ultimately shut down, leaving Zynex as the only credible player in the market. Zynex designs manufactures, and markets medical devices designed to treat chronic and acute pain, as well as activate and exercise muscles for rehabilitative purposes with electrical stimulation. The company focuses on small, portable and battery-operated devices for home use. Its electrotherapy product is a safe and effective alternative to opioids for pain management. The company is well capitalized with net cash ~US$30m and is now generating free cash flow after investing ahead of the curve to onboard market share from downed competitors. Zynex is trading on about 9x EV/EBIT and is growing strongly.

Channel Advisor (ECOM.US) – share price made up some lost ground in June. Channel Advisor provides a cloud platform to online businesses of brands and retailers to integrate, manage and optimise their online sales across hundreds of channels through a single web-based platform. The suite includes several modules, each that integrates with a particular type of channel, such as third-party marketplaces, digital marketing websites and authorised resellers, or supports a specific online functionality such as sales and brand analytics and fulfilment. The share price has had a sharp retracement this year due to concerns about sustainability of online spending after a heady couple of years which would impact its customers economics and therefore revenues which have an element of variability depending on volumes. The company has a strong balance sheet with >US$120m of cash and is not expensive (13x EV/EBIT) if earnings can be maintained in a tougher environment.

Major Detractors for the Month

Core Labs (CLB.US) – fell nearly 30% last month as the oil price declined about 6% from very high levels intra-month. CLB is a leading provider of proprietary and patented reservoir description and production enhancement services and products used to optimise petroleum reservoir performance. It is heavily exposed to the oil and gas industry in the USA and Canada, hence the lack of new development in those markets has led to earnings declining for the last three years. With higher oil and gas prices we believe industry underspend could swing back the other way which would mean a positive operating environment for Core Labs. The balance sheet is modestly geared, and we forecast a return to levels of profitability last seen in FY19 over the next two to three years, which is not fully reflected into the share price.

SONOS (SONO.US) – declined over 18% in June, we used this downturn to re-purchase a position after exiting some time ago. Sonos is one of the leading players in a highly fragmented field of HiFi entertainment. It was founded in 2002 and was the first company to link speakers over a WIFI network. They have consistently expanded their product offering and managed to keep their products relevant via an updateable software layer which sits on top of the physical layer which is their unique point of difference. The company has over US$600m of cash and is trading on 7x EV/EBIT.

Zillow (Z.US) – share price continued to collapse in June, falling another 20%. It has fallen nearly 90% peak to trough in an extraordinary evaporation of market capitalisation (~$30bn) over the last 18 months. We used the weakness in June to initiate a position in the business, as we believe the risk-reward equation is now skewed in our favour. Zillow is the leading property portal in the USA similar to Realestate.com.au (REA.ASX) in Australia, however, the business model is not as strong given Zillow does not own the inventory given the existence of a central database (IDX) which is governed by the National Association of REALTORS. This means it cannot charge the vendors to advertise and is reliant on selling leads to buyer's agents for a commission and third-party advertising. Nonetheless, we believe there is significant latent value in having the largest audience in the market and despite vagaries of the property market it will be able to further monetise this position in the medium to long term. By the end of the calendar year, we expect Zillow to have approximately US$2bn of net cash as it completes the unwind of the property inventory accumulated for its property "flipping" strategy that it has exited, which means the business is trading on approximately 14x EV/EBIT on our forecasts.

Outlook & Strategy

It's grim for those companies that are burning cash and have little runway to raise money from previously benevolent shareholders, we feel there is a wave of insolvencies coming in this complex. This process though painful will ultimately be a healthy cleanse for the economy and the sharemarket, as many of these so-called "disrupters" were undermining returns for legitimate companies and had never formulated a path to an economic business model but were simply being propped up by cheap money from central banks. Those days feel over.

Whilst the economic backdrop will be difficult for our companies as revenues will be under pressure, we believe they will survive and likely thrive on the other side as the return equation improves – addition by subtraction really. Those investing on macro-economic themes are likely to find it difficult moving forward, we think bottom-up fundamental analysis will again shine and like the dot-com bust and the ensuing recession (shallower than expected in hindsight) it will be those portfolios that are biased to cash flows, solid balance sheets and sensible valuations that will generate the strongest returns for clients.

Platform Availability List

The Spheria Global Microcap Fund is available on the below Platforms. Please check with your platform for minimum investment requirements and fees.

BT Panorama

HUB24

Macquarie Wrap

Netwealth

Praemium

Spheria Global Microcap Fund	
Benchmark	MSCI World Micro Cap Index
Investment Objective	Outperform the MSCI World Micro Cap Index in AUD (Net) over the long term
Investing Universe	Global listed microcap equities predominantly in developed markets with a market capitalisation of US$1.0bn and below at time of purchase
Holdings	Generally 30-80 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
Expected Turnover	20% - 40%
Style	Long only
APIR	WHT6704AU
Minimum Initial Investment	$25,000

Spheria Global Microcap Fund

ARSN 627 330 287 | APIR WHT6704AU

Fund Ratings

Zenith APPROVED

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 Global Microcap Fund (ARSN 627 330 287) (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 Global Microcap Fund – June 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/.