Spheria Opportunities Fund

ARSN 144 032 431 | APIR WHT0025AU | mFund SPM03

Performance as at 30th June 2022

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a[3]
Fund[1]	-7.8%	-14.2%	-5.2%	6.8%	9.3%	9.3%
Benchmark[2]	-11.7%	-17.5%	-14.1%	4.1%	6.6%	7.2%
Difference	3.9%	3.3%	8.9%	2.7%	2.7%	2.1%

1 Spheria Opportunities Fund. Returns of the Fund are net of applicable fees, costs and taxes.
2 Benchmark is the S&P/ASX Mid-Small Accumulation Index.
3 Inception date of the current investment strategy is 11th July 2016. The Fund was established in June 2010. Past performance is not a reliable indicator of future performance. All p.a. returns are annualised.

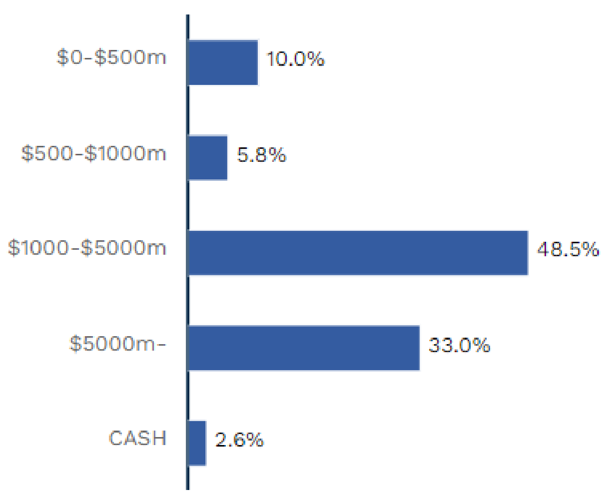
Overall Commentary

The Spheria Opportunities Fund returned -7.8% (after fees) during the month of June, outperforming the S&P ASX Mid-Small Accumulation Index by 3.9%.

Top 5 Holdings

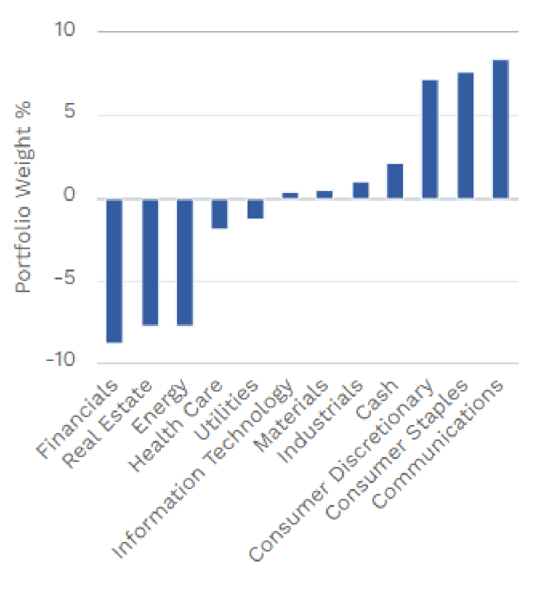
Company Name	% Portfolio
REA Group Ltd	6.2
The A2 Milk Company Limited	5.9
Alumina Limited	5.7
Flight Centre Travel Group Limited	5.5
Incitec Pivot Limited	5.0
Top 5	**28.2**

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

Legendary investor Warren Buffett is famous for saying "Only when the tide goes out do you discover who's been swimming naked."

We think this is an apt analogy of what has played out in the last six months as sharemarkets continued their sell-off into June, as global 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, as per usual, 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 have largely avoided the "cash burning crowd" as our process requires companies to be generating positive free cash flow (after all capital expenditures) or to do so with a high degree of certainty within a five-year time frame. The latter type being a very small component of our overall portfolios. Also, we have avoided companies where valuations were simply absurd – a manifestation of a long bull market and money printing when companies are trading on multiples of >50x and the market glibly thinks it's normal. This has protected our relative performance but is clearly no solace for those focused on absolute returns.

Many of our consumer exposed names have fallen significantly since the start of the year on the portent of weaker spend which has a feeling of inevitability, however, the duration and extent of which is unknown. Regardless, consumer exposed companies we own, in our view, are in a position of relative and absolute strength with respect to balance sheets (mostly net cash) and valuation multiples which were already incredibly low preceding this expected downturn, such that even if earnings halve the multiples will still be absolutely attractive e.g. Michael Hill (MHJ.ASX) would go from a multiple of 4x EV/EBIT to 8x and still have +$100m of net cash.

Major Contributors for the Month

REA Group (REA.ASX) – was broadly flat for the month significantly outperforming the index. REA is a name we re-entered during the month when the share price had fallen over 40% peak to trough. We had exited our position during 2021 due to a lack of valuation support and heightened risk around the vagaries of the property cycle. Whilst we are cognisant that a higher interest rate environment is a headwind for property markets, REA is the leading property portal in the country with more than 3x the visits of its nearest competitor, operating in a near duopoly market with Domain (DHG) being the other main player, which provides scope to offset volume declines with price increases. In addition, over the last two years the need for marketing was reduced as agents were finding private buyers for properties before they were listed as demand was unusually strong. As demand slows the need for effective marketing and the use of platforms like REA will be even greater. As such we believe the negative sentiment and headwinds are captured in the share price and with the business trading below its long-term average EV/EBIT we believe there is sound valuation upside from current levels.

Atlas Arteria (ALX.ASX) – jumped 12% in June after the company advised that IFM Global Infrastructure Fund had acquired approximately 15% of their issued shares at a premium of over 16% above the previous close price. We vended our entire holding into the IFM bid as we believed it represented reasonable value given the risk surrounding extension of the concession (2034) for the main asset being the APRR toll road in France. Also, given the sharp intra-month downturn in sharemarkets we were able to redeploy proceeds into better relative investments including REA.

IRESS (IRE.ASX) – rose 10% over the month retracing some of its losses in recent months. IRE is a high-quality software company with significant pricing power in its key verticals. This will allow it to weather cost pressures which are prevailing in the technology sector. It also has strong user loyalty in both the asset management and adviser channels in Australia and the UK, with customer churn rates at just 1.4% p.a. The company has implemented a share buyback ($100m) and is relatively inexpensive at 20x EV/EBIT with low debt levels and strong cash flow generation.

Major Detractors for the Month

Here, There & Everywhere (HT1.ASX) – declined over 26% in June as the media sector came under pressure due to expectations around an advertising recession. However, we do not believe the outlook to be so dire and conversations with management and more broadly suggest advertising spend is holding up well currently, this will change but is more than reflected in the trading multiple, in our opinion. Balance sheet debt is under control at <$100m (vs $70-80m of EBIT) and the company has a 25% stake in Soprano which is highly profitable and growing strongly, whilst its key competitors are cash burning, which we think plays out in Soprano's favour. HT1 is the No.1 rated metro radio network in Australia and recently acquired the largest regional player (Grant Broadcasters), to expand and complete its national presence and grow its digital offering, IHeartRadio.

Bega Cheese (BGA.ASX) – fell 21% in June as cost pressures appear to be weighing considerably on the business. In April 2022 the business revised guidance lower owing to substantial cost headwinds arising from COVID-19 absenteeism, floods in NSW and QLD and farmgate milk prices continuing to rise. Whilst the first two appear to be somewhat one off in nature, the latter has been more challenging to overcome. Farm gate milk prices continue to rise reaching record levels of $9.10/kg in June, being driven by record international dairy prices as well as elevated competition amongst dairy processors. Despite the record levels, Australian milk production remains sluggish with dairy cattle numbers falling as farmers take advantage of high cattle/beef prices. This combination of strong demand and weak supply is being felt by Bega and impacting input costs. To help offset some of the pressures Bega began raising prices late last year and we believe they will raise prices again in July to offset ongoing cost pressures. However, given increased prices lag, the business's earnings are likely to be depressed short term. With the company trading below its long run average EV/EBIT multiple, and the strength of its brands we believe it remains attractive on a look through basis.

Ampol (ALD.ASX – not owned) – rose 3% over June which in a very weak market detracted from our performance because we don't own it. ALD is benefiting from higher refiner margins and the ongoing recovery in fuel demand. Its retail fuel outlets are fairly oligopolistic in nature whilst its refining profits can be volatile depending on Asian refining margins. In the long term, the company faces a major threat from the potential transition to electric vehicles which will affect demand for fuel.

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

If a fund is not available on your preferred platform, please contact us.

Please check with your platform for minimum investment requirements and fees.

FNZ Group

HUB24

mFund

Praemium

Macquarie Wrap

Spheria Opportunities Fund	
Benchmark	S&P/ASX Mid-Small Accumulation Index
Investment Objective	Outperform the S&P/ASX Mid-Small Accumulation Index over the medium to long term
Investing Universe	Primarily listed companies outside the top ASX 50 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	0.99% p.a. Management fee & 15% 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, risk aware
APIR	WHT0025AU
Minimum Initial Investment	$25,000

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Fund Ratings

Zenith RECOMMENDED

Further Information

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

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