

Performance as at 30th September 2021

	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.	Inception p.a ³
Fund ¹	0.4%	5.4%	42.2%	11.3%	13.1%	12.9%
Benchmark ²	-1.4%	3.7%	32.4%	11.0%	11.8%	12.2%
Value Added	1.8%	1.7%	9.9%	0.3%	1.3%	0.7%

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.



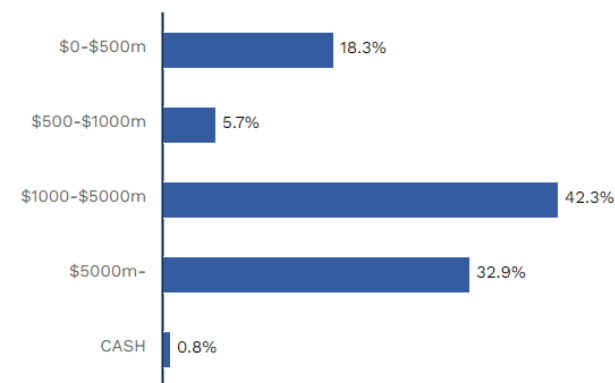
Overall Commentary

The Spheria Opportunities Fund returned 0.4% (after fees) during the month of September, outperforming the ASX Mid-Small Accumulation Index by 1.8%. Over the past year the Opportunities Fund has returned 42.2% beating its benchmark by 9.9%.

Top 5 Holdings

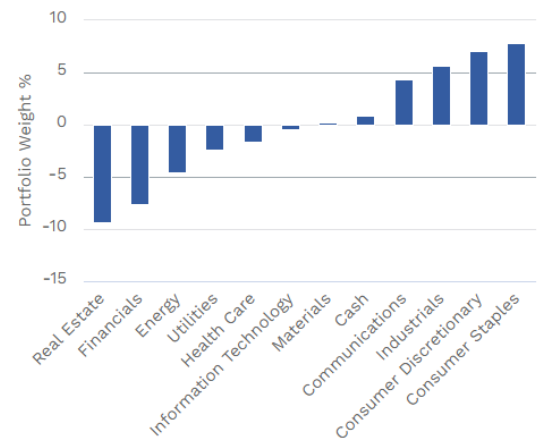
Company Name	% Portfolio
Orora Limited	6.0
Blackmores Limited	5.4
Incitec Pivot Limited	4.6
Flight Centre Travel Group Limited	4.5
Alumina Limited	4.2
Top 5	24.7

Market Cap Bands



Source: Spheria Asset Management

Active Sector Exposure



Source: Spheria Asset Management

Markets

Markets declined both here and internationally over September after putting in a robust performance in the previous month. The Smaller Companies index was dragged down by materials, healthcare and software and services which took a breather after posting strong returns over the past year. The beaten down Energy sector bounced hard with oil and energy prices maintaining their upward trajectory and demand recovering in the Northern Hemisphere with economies re-opening. Oil prices are touching US\$80/bbl a level not seen since mid 2014 with US gas prices also back up to a 7 year high. Gas supplies appear to be extremely tight in Europe and the UK in particular causing some significant increases in prices in local markets.

Transport and travel names also performed well as investors started to look through to the Australian economy re-opening and the re-commencement of local and international travel (finally!). We believe we are in the midst of a massive spending shift from goods back to services. The synchronised global spike in demand for goods has strained global manufacturing from chips to automobiles and put significant upward pressure on freight rates and port logistics. As people are allowed to travel again, we would expect a significant reversal back to services and in particular travel and leisure which has been suppressed by Government mandated travel restrictions. Early signs in New Zealand showed the big jump in travel demand massively exceeded the travel undertaken in 2019 and assuming capacity is restored it would seem likely that we will see the same development in Australia.

The other major issue investors are grappling with remains inflation and the long-term bond rates implied by rising inflation. So far, the official narrative from Central Bankers remains that this increase in inflation is temporary, however we remain sceptical. We use an 8% discount rate in all our models and implicit in this is a 3% 10-year bond yield (vs. around 1.5% as we write this) and an equity risk premium of 5%. We think rates are likely to trend back up over time and importantly our valuations assume this to a reasonable extent. We would suggest that investing in stocks now whose sky-high valuations are predicated on the assumption that rates stay sustainably this low for a long time from here really is metaphorically speaking akin to reaching down in front of a bulldozer to pick up pennies.

Major Contributors for the Month

Flight Centre (FLT.ASX) was the most significant contributor to the Fund which took off over September returning 30%. FLT reported a depressed set of earnings in August as travel volumes cratered over the previous twelve months but indicated that they were starting to see a reasonable re-bounce in both corporate and retail bookings towards the end of the fiscal year. FLT has continued to win significant business in FCM – their corporate side – whilst undergoing heavy restructuring on their retail side. This will mean earnings and margins could well re-bounce to levels higher than they were prior to Covid 19 restrictions taking effect.

Alumina Ltd (AWC.ASX) was the next largest contributor as it rose 18% over the month. AWC owns a 40% share in AWAC (Alcoa World Alumina and Chemicals) which is one of the world's highest quality and lowest cost Alumina producers (raw material input into aluminium smelting). Two major events over the month – a fire at the Jamalco refinery in Jamaica followed by a military coup in Guinea – lead to a major jump in Alumina prices. To some extent, Alumina and aluminium prices are finally playing catch up to the other base materials complex. AWC has no gearing, produces consistent cashflows and is one of the cleanest from an environmental point of view producers in the world. We view this an attractive long-term asset for the Fund.

Technology One (TNE.ASX) gained 15% over the month as the company announced the acquisition of Scintia Plc – a UK based Syllabus software optimisation program for GBP12m. Whilst this was a small deal for TNE, brokers took the chance to upgrade target prices based on the company's continued move to a SAAS (Software as a service) offering. TNE remains one of Australia's outstanding home-grown technology success stories – genuinely competing against and beating global giants SAP and Oracle in Local Government and Education ERP software tenders. TNE's balance sheet is solidly net cash, cash conversion is amongst the best in the smaller companies universe however TNE's valuation is now starting to look more full to us on a relative basis.

Major Detractors for the Month

Seven West Media (SWM.ASX) detracted as the share price retraced 18% over the month on limited news flow. As we have discussed in previous monthlies, SWM is one of the cheapest media franchises in the country with a strong management team who are executing on a cost out and de-levering of the company's balance sheet. SWM has attracted a significant increase in their digital audience on their BVOD (broadcast video on demand) services after their success in showcasing the Olympics. How they monetise this and control costs remains crucial to the medium-term story. We view their business as being central to any likely media consolidation in Australia, yet the company trades on a mere 4.5x EV/EBIT.

Class Ltd (CL1.ASX) declined 12% during the month again with limited obvious catalyst other than the market's simple ennui with small technology firms. We remain attracted to the high customer retention rate at Class (99.1%) and the strong organic growth prospects they have in their product adjacencies; Class Portfolio and Class Trust as well as Doc tech under their NowInfinity brand. CL1 continues to look extremely attractive compared to most technology firms listed in the smaller companies space on just 14x our estimated FY22 EV/EBIT.

Orora (ORA.ASX) declined a relatively modest 6% over the month on limited news flow. We continue to like ORA given it trades on an EV/ EBIT of sub-12x for a high ROIC duopoly business in Australian beverage packaging (with well above WACC investment opportunities in cans and where returns from the glass business are artificially depressed from the transient impacts of the Chinese wine tariffs) and a U.S. packaging business that is now firmly on the recovery path but well off the margin levels management are targeting. The U.S. business in particular also represents opportunities for M&A either as a purchaser (in the Orora Packaging Solutions business) or as a vendor (for the underperforming Orora Visual Solutions). Orora also has an underleveraged balance sheet with net debt to EBITDA < 1.5x (vs. target 2.0-2.5x) and retains ownership of all its major manufacturing sites in the Australian business. Given the lower growth fibre business was sold to Nippon paper for 17x EV/EBIT in 2019 we would not be surprised to see the stock the target of corporate activity.



Outlook & Strategy

As has probably become apparent from the commentary above we see a number of significant economic pivot points approaching. The first is a consumer spending swing back to services and away from goods. The second pivot point is the possibility of higher medium term interest rates and more persistent inflation than our Central Bankers would have us believe. Change leads to opportunity – the key is to be prepared and willing to make investment changes. We remain surprised, although we have been around long enough not to be so, by the over-enthusiasm investors appear to have for money-losing disruptors in the small and mid-cap space. We are however more convinced by long-term investment history which suggests that unless new ideas make money in a reasonable timeframe, the fascination eventually wears thin, and investors will jump on board the next new thing leaving the old idea to wither in the market’s basement of forgotten dreams.

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

Fund Ratings



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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