SEC Results 1HFY23

1HFY23 Profit	Company Performance[1]	Dividends[2]	Yield	Yield (including franking)
$4.3m	+4.0%	4.3c	4.8%[3]	6.8%[4]

- **1HFY23 net profit after tax of $4.3m**
- **Company Performance of +4.0%, -3.0% compared to benchmark[5] of +7.0% (+2.0% p.a. to benchmark since inception);**
- **Quarterly dividends declared for the half-year of 4.3 cents per share (fully franked)[2]**
- **Trailing dividend yield equal to 4.8%[3] (6.8%[4] including franking)**
- **Shareholder webinar on results and portfolio**

Performance

We are pleased to announce that Spheria Emerging Companies Limited (ASX:SEC) (**Company**) recorded a profit of $4.3m for the half-year ended 31 December 2022 (**1HFY23**). Although economic conditions continue to be volatile, an increase in asset values as markets recovered from the losses experienced in the 2nd half of the 2022 financial year (**2HFY22**) and steady dividend revenue from portfolio investments supported the profit for the half.

During the half-year Company Performance, which comprises investment portfolio performance after deducting investment management fees and Company administration expenses (excluding taxes), was +4.0%. This compared to benchmark performance of +7.0% for the half-year.

While performance for the half-year was below benchmark, the Company continues to exceed its benchmark since inception, with Company performance of +5.5% compared to benchmark performance of +3.5%. This performance since inception is especially pleasing as the Company marked the 5th anniversary of its IPO in December 2022.

Quarterly dividends

The Company continued to pay quarterly dividends during 1HFY23, at a rate of 1.0% of the Company's post-tax NTA at the end of each calendar quarter.

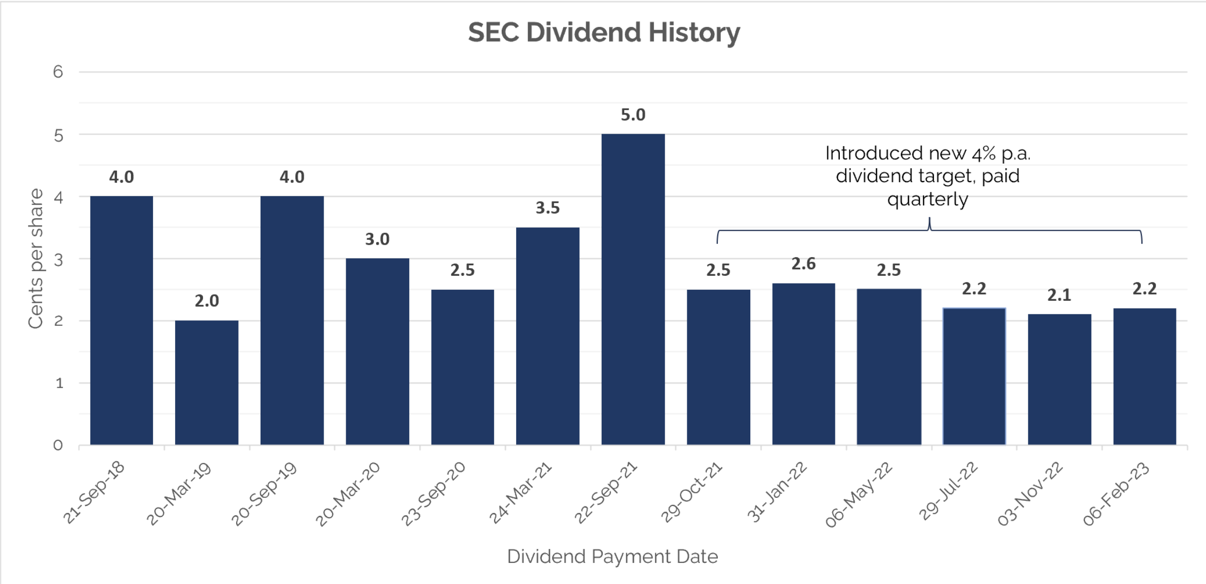
The Company declared a total of 4.3 cents per share in fully franked dividends for 1HFY23[2], which when combined with dividends from 2HFY22 of 4.7 cents, represents a trailing dividend yield of 4.8%[3] based on the 31 December 2022 share price of $1.89, and a gross yield (including franking credits) of 6.8%[4].

The quarterly dividends paid for 1HFY23, fully franked at a 30% tax rate, were as follows:

Quarter ended	Value per share	Date paid
30 September 2022	2.1 cents	3 November 2022
31 December 2022	2.2 cents	6 February 2023

[1] Calculated as the Company's investment portfolio performance after fees excluding tax on realised and unrealised gains/losses and other earnings, after Company expenses.
[2] Comprising September 21 quarter dividend of 2.1 cents (paid 3 November 2022) and December 22 quarter dividend of 2.2 cents (paid 6 February 2023).
[3] Trailing dividend yield based on total quarterly dividends for calendar year 2022 of 9.0 cents, calculated on share price as at 31 December 2022 of $1.89.
[4] Trailing dividend yield including franking credits based on total quarterly dividends for calendar year 2022 of 9.0 cents, calculated on share price as at 31 December 2022 of $1.89, using 30% tax rate.
[5] S&P/ASX Small Ordinaries Accumulation Index

Including these quarterly dividends, the Company has now paid 38.1 cents per share total dividends since its ASX listing in Dec 2017, equivalent to 19% of the IPO price of $2.00.

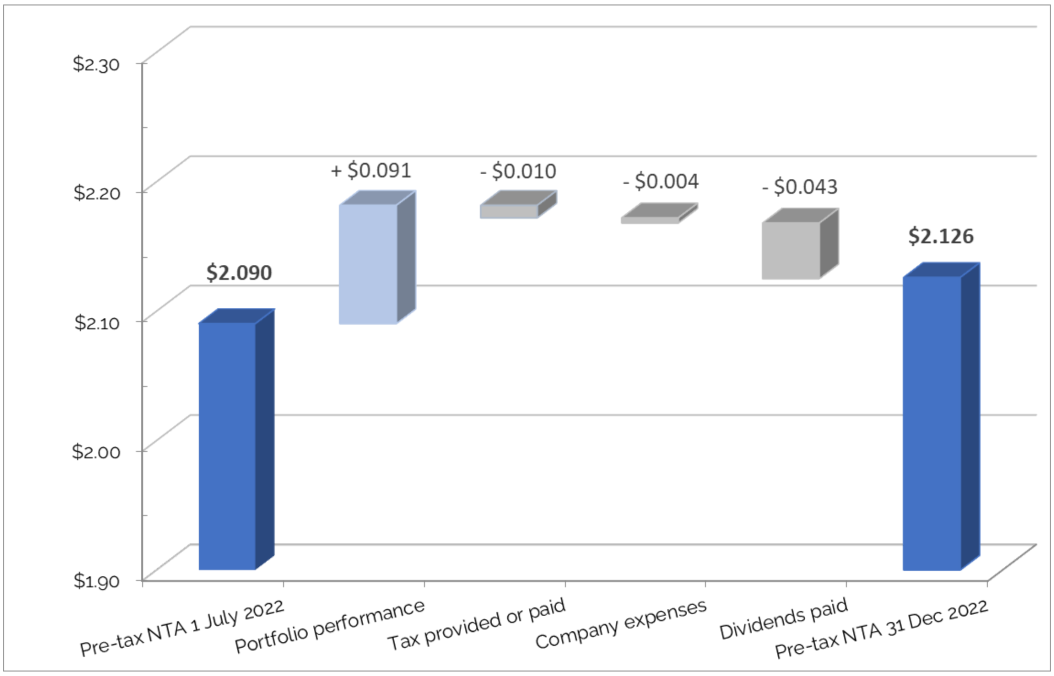


The Company intends to continue the payment of quarterly dividends at a level equivalent to 1% of the post-tax NTA of the Company, subject to available profits, cash flow and franking credits.

At 31 December 2022, the value of the Company's franking account was $6.7m or $0.111 per share. This is equivalent to $0.259 per share in fully-franked dividends at the Company tax rate of 30% and the Company presently maintains sufficient profit reserves for this value of dividends.

NTA performance breakdown for 1HFY23

In 1HFY23 the pre-tax NTA increased by $0.036, from $2.090 at 30 June 2022 to $2.126 at 31 December 2022. The increase in NTA is after the payment of taxes, Company expenses and dividends during the half-year, which totalled $0.057.



The post-tax NTA of the Company as at 31 December was $2.180 per share, which was $0.054 higher than pre-tax NTA, representing the value of tax on unrealised investment portfolio losses at period end, at the Company's tax rate of 30%. This difference between pre-tax and post-tax NTA fluctuates as unrealised gains and losses are made on SEC's investments.

Discount to NTA

The discount between the Company's pre-tax NTA per share and its share price stood at 11.1% on 31 December 2022[6].

While the discount has increased during the half-year, there has been a meaningful improvement since the 25% discount reached in 2020, and the Board remains committed to its reduction.

Shareholder webinar on results and portfolio

The Board invites you to the upcoming shareholder webinar on 28 February 2023 at 11.00am (AEDT). The webinar will provide an update on the Company's half-year financials and investments from the Company's director and Spheria Asset Management's Portfolio Manager, Matthew Booker.

Shareholders are invited to register at the following link:
SEC Half-Year FY2023 Results Presentation

The Board of Spheria Emerging Companies Limited has authorised this announcement to be released to the ASX.

[6] Calculated on 31 December 2022 pre-tax NTA per share of $2.126 and share price of $1.89.

Additional shareholder information

Performance as at 31 December 2022

	1HFY22	Since inception p.a.
Company*	**+4.0%**	**+5.5%**
Benchmark**	**+7.0%**	**+3.5%**
Difference	**-3.0%**	**+2.0%**

* Calculated as the Company's investment portfolio performance after investment management fees excluding tax on realised and unrealised gains/losses and other earnings, after Company expenses.
** S&P/ASX Small Ordinaries Accumulation Index.

Manager's commentary

Portfolio performance

The investment portfolio increased 4.2%[7] for the six months to December 2022 underperforming the Benchmark by 2.8%. Markets and asset prices broadly recovered over 1HFY23 as the shock of interest rate rises was absorbed and evidence emerged that supply chain issues were starting to normalise. Inflationary forces which had been making their way through the system in late 2021 and early 2022 were better understood with Covid related demand exaggerating short-term demand for goods at the expense of services around the world.

With the benefit of hindsight it appears fiscal and monetary policies were too accommodating during the Covid pandemic. This was added to by the actions of Central Banks who were creating money supply at the fastest rates we have seen in decades plus turning to unconventional monetary policy to provide further liquidity. In this case they provided forward guidance and bought assets (bonds) back to control long dated interest rates and provide the money market with additional liquidity. All this was heaped onto economies that were constrained from consuming many services (travel, leisure, restaurants etc) leading to exacerbated demand for goods. Its little wonder then that global supply chains creaked! Everything from computer chips to manufacturing capacity to shipping and transport costs spiked which kicked off the inflation genie.

Having suppressed interest rates from natural market levels, once Central Bankers realised they had to take their feet off the collective gas, rates had further to rise and in less time. This caused the market to panic over 2HFY22. With discount rates having receded from investors minds as somewhat of a relic of former times, many had to be reacquainted with the term "discounted" cash flow. 10 year bond yields rose from around 1.7% in Jan 2022 to around 3.7% by mid year. They closed the year slightly higher at just over 4% but fears that long dated bonds could have skyrocketed higher were being eased by some early indications that a lot of inflationary pressures (absent labour markets) were easing.

This backdrop gave stock market investors some cause for relief and markets recovered some of their losses from 2HFY22. Some M&A activity returned as PE funds waded into very beaten-up sectors – namely the technology sector – to snap up assets that had been sold down 70-90% from a year ago. It is astounding how rapidly and by how much the perception of the valuation of software businesses can change for instance. Top contributors to returns for the half-year included Nitro Software (NTO.ASX) up 66%, Monadelphous (MND,ASX) up 37% and Insignia Financial (IFL.ASX) up 29% over the half.

[7] after investment management fees. After deducting Company administration expenses (excluding taxes), Company performance was 4.0%

NTO is a good example of a software business that was previously quite highly rated by the market but whose share price fell as the company decided to invest more heavily into growth at the expense of near term cash flows. NTO provides productivity software for the editing and saving of pdf documents (a competitor to Adobe Acrobat) with the same functionality at around half the cost. They are also moving into e-signing – a field we think will be massive in time as people and companies learn to trust the veracity and authenticity of digital signatures. Having started the calendar year at around $2.45 a share, NTO fell to a low of $1.10 in July before receiving a takeover offer at $1.58 from Potentia (a local technology centric PE fund) in late August. In October Alludo (backed by KKR out of the US) bid $2.00 a share and subsequently raised their bid $2.15 after a counter from Potentia. This is where the current situation stands although there are still a few weeks for the final bids to play out. Having declined all year, deal volume spiked in the final quarter of Calendar 2022 with a number of other notable deals in small caps including Nearmap (NEA.ASX) and Tyro Payments (TYR.ASX).

Detractors to performance over the half-year period included City Chic (CCX.ASX) down 74%, Adbri (ABC.ASX) down 30% and FlightCentre (FLT.ASX) down 17%. City Chic is worth delving into. SEC previously owned CCX around the time the business separated itself from Speciality Fashion Group in late May 2018. CCX grew both organically and via international online acquisitions (namely of Avenue in the US and Evans in the UK) with the share price improving almost tenfold over the period that we owned it. Having exited most of the holding in late 2021 we bought back into CCX after its initial profit warning in August this year. CCX along with many other retailers had interpreted the strong demand over Covid as being more sustainable than the surge proved to be, this was compounded by supply chain issues in China due to rolling lockdowns that pressured the company to purchase stock ahead of schedule. As a result CCX acquired too much inventory which put the company into a modest debt position whilst earnings were falling due to clearance activity, bringing into play banking covenants. As the shares have fallen we have added to the position. Our logic is that whilst earnings will remain under pressure cash flows will be relatively strong, which will repair the balance sheet. The company has restructured its debt providing breathing space for this process. The market heavily imputed potential solvency issues into the share price prior to the debt restructure with little relief since. On a longer term view as margins recover we believe we are paying a very low single digit multiple of EBIT for the retailer. We have often made outsized returns for investors by selectively taking on stocks that other investors have abandoned on the back of what we believe are temporary business setbacks.

Market outlook

We are entering a period of slowing global growth and a likely downdraft in earnings for the broader stockmarket. This view however is well known as are the risks around the consumer spending during Calendar 2023. Who hasn't heard of the "mortgage cliff" or the impact of rising energy prices on forward looking consumer spending? In our view a lot of the obvious macro threats are frequently more than priced into stocks from a bottom up perspective. Our investors often ask us for our "macro view" on the market and we have to honestly say we don't spend a huge amount of our time adding our macro views the plethora of other views being bandied around by the "experts". The reason is simple. Even if we had a perfect crystal ball – which we don't – our perfect view of the future macro environment would translate very poorly into investment success. The reason for this again is obvious. The market is a constant forward looking probability adjusting machine. It's not always right of course but it reflects a LOT of the current views of the participant investors at any point in time. If everyone is worried about consumer spending, then consumer stocks are likely to have been sold off heavily once that view has become consensus.

The team at Spheria spends the vast majority of our time looking at businesses from the bottom up. We try to assess what is priced into stock prices and assess opportunistically whether the bad news is more than priced in or conversely whether the good news we might expect is not fully priced in.

More broadly, we continue to see good opportunities in the small- and micro-cap space in which SEC invests. The small-cap space was more heavily sold off than larger cap stocks over Calendar 2022 and has not fully recovered from the heavy sell off last year. The natural volatility of smaller companies also continues to throw up attractive opportunities. Finally, as we have detailed in the report above, we have been the beneficiary of a number of takeovers over the years based on our focus on cash flow generation and valuation which lies at the heart of our investment process. Nitro is currently under bid from a number of Private Equity firms and our sense is that as rates stabilise M&A activity in the smaller cap space could resume with some gusto.

We thank our shareholders for their interest in and support of the Company and would welcome your questions and participation in our results and conference calls.

About Spheria Asset Management Pty Limited (Manager)

Spheria Asset Management Pty Ltd is a fundamental-based investment management firm with a bottom-up focus, specialising in small- and micro-cap companies, which can provide higher returns in the long term than their larger peers.

The Manager is majority owned by its team, which has nearly 100 years of combined investment experience. The Manager's performance culture is underpinned by sensible incentives, a focused offering and the outsourcing of non-investment functions to minority partner Pinnacle Investment Management Limited.

Find out More about the Company and Manager

To find out more information about the Company, please visit the SEC Website
To find out more information about the Manager, please visit the Spheria website

Contact Us

If you have any questions for the Company, please reach us on 1300 010 311
If you have any questions regarding your shareholding, please call Automic, the Company's share registry on 1300 902 587