Emerging Companies Fund

Monthly Update: April 2017

Dear Fellow Investors,

I am pleased to provide you with another update on the performance of our Emerging Companies Fund.

As you will note from the commentary below, April proved to be another challenging month for the emerging companies market (index was -5.9%), with significant headwinds created by ongoing strong negative sentiment towards micro-cap companies. Despite this, the Fund again demonstrated its resilience and was on track to deliver a positive return until the very last day of the month, when it slipped slightly into negative territory.

Performance summary

	February	March	April	Since Inception
Saville Capital Emerging Companies Fund[1]	-3.2%	+2.6%	-0.6%	-1.3%
Benchmark[2]	+0.4%	+0.4%	+0.4%	+1.1%
Relative Performance	-3.6%	+2.2%	-1.0%	-2.4%

[1] *Net of all base fees, performance fees and expenses of the Fund*

[2] *RBA cash rate +3% (per annum)*

Performance commentary

The Fund decreased in value by 0.6% during April, which while certainly not the preferred outcome in absolute terms, was a very solid result in a relative sense (see further detail on this in our Market commentary). The key drivers of our strong relative performance were our positions in Shaver Shop Limited (SSG +24.5%) and National Veterinary Care (NVL +6.5%). While NVL increased in value without any news flow, SSG announced a significant upgrade to its FY17 earnings guidance. The key driver of the upgrade was the recent emergence of customers buying select products for resale to consumers in Asian markets. Nonetheless, we also understand that like-for-like (LFL) sales within its “core” business also turned positive during March/April, following negative LFL sales growth in the preceding three months.

Despite the substantial share price appreciation following this announcement, we remain committed holders of SSG given that momentum amongst its core customer base appears to be rebounding, c.25% of its store portfolio is still in ramp-up mode (i.e. <2 years old) and any ongoing demand from buyers for Asian markets (which remains plausible) represents upside. Despite its attractive growth outlook (our modelling suggests that c.15-20% EPS growth in FY18 is achievable), the stock is trading on a FY17 P/E of <10x. We will discuss our investment thesis for SSG in more detail in a subsequent monthly update.

Most of our other investment positions experienced modest declines during April, with the largest detractor from our performance being Think Childcare (TNK), which was down 9.2% for the month despite making a positive announcement regarding funding for one of its incubators that delivers a solid pipeline of potential future childcare centre acquisitions.

Market commentary

As we have already alluded to, the Emerging Companies Accumulation Index (XECAI) again experienced a very weak month, declining by 5.9% in April. While not perfect, we believe that this index most closely reflects sentiment towards those stocks targeted by our Fund's investment strategy. The key flaw in the comparison is that the XECAI includes industrials (c.75%) and resources (c.25%), the latter of which are specifically excluded from our investment mandate. Nonetheless, the market cap weighted average share price performance of all industrial stocks within XECAI (i.e. excluding resources) during April was –4.4%, so only marginally better than the performance of the broader index.

The reason we prefer the XECAI over the Small Industrials Accumulation Index (XSIAI), which specifically excludes resources, is because the average market cap of the XECAI (c.$200m) is more closely correlated with that of our Fund (c.$190m), reflecting our clear preference for investing in stocks with a market cap of <$500m. Conversely, the average market cap of the XSIAI is c.$1.1bn, therefore its performance tends to be heavily influenced by the much larger ex-ASX100 industrial companies, most of which we are unlikely to own under our investment strategy given their size.

Company in focus: Afterpay Limited (AFY)

In this monthly update we provide a summary of why we have added AFY to the portfolio, which was up 8.8% in April following a very strong 3Q FY17 business update to the market.

AFY is a technology driven payments company which facilitates transactions between retail merchants (online and in-store) and their customers by offering a 'buy now, pay later' service. The end-customer then makes four equal fortnightly instalments which are automatically taken from their debit or credit card. The end-customer does not pay any upfront fees or interest to AFY, however a $10 late payment fee is incurred if insufficient funds are available for any given instalment. In exchange for providing this service, AFY receives a fee (c.3.5%) from the retail merchant on each Afterpay transaction.

In order to manage its credit default risk, AFY utilises a proprietary digital platform and transaction integrity engine that performs real-time fraud and repayment capability assessments. During 1H FY17, AFY's net transaction loss was an impressive 0.7%. We understand that AFY's typical customer is a 25-34yo female buying fashion clothing online. The nature of the customer, the small average transaction size, short credit duration and automated repayment process all combine to give us comfort around the default risk facing AFY, which is our key longer term concern as an investor in the stock.

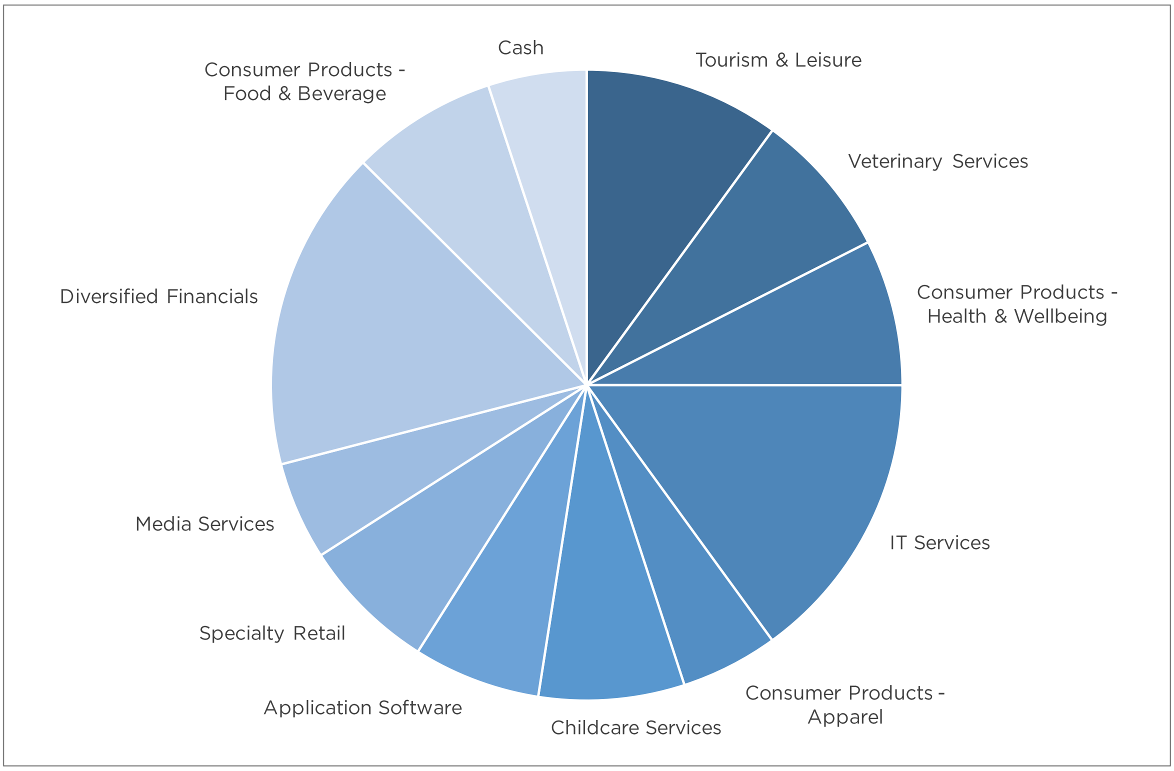
Despite having been in operation for less than two years, AFY already has more than 575,000 unique end-customers on its platform and more than 3,700 retail merchants. As a result, AFY is now processing c.3% of total Australian online retail transactions and c.15% of Australian online fashion retail transactions. Its merchant customers include a broad range of major retailers such as Cotton On, Myer, Country Road, Rebel, Officeworks and Beacon Lighting. While AFY's initial success has been in driving higher online retail sales for its merchant customers, that success is now leading to the roll-out of its payments service across many of its merchants' physical store networks as well.

AFY remains in a high growth phase, as evidenced by its 3Q FY17 business update which reported 75% (quarter-on-quarter) growth in the number of integrated retail merchants, 40% growth in merchant fees and 56% growth in end-customers. These figures are particularly impressive when taken in the context of cycling the seasonally strong 2Q, which obviously includes the Christmas period.

AFY is trading on an FY18 P/E multiple of c.40x, so on face value it certainly doesn't appear "undervalued", however our research to date (including discussions with prominent retailers that offer Afterpay to their customers) gives us confidence that AFY will continue to generate very strong earnings momentum that will more than justify the current multiple. This view is also validated by own DCF valuation of $3.85/share (vs share price of $2.34 as at 30 April 2017), which we believe is based on a reasonable set of medium to long term assumptions for the business.

Portfolio characteristics

We currently have 95% of our capital invested in 16 stocks, with the remainder held in cash. Since our last update, we have added AFY and trimmed our exposure to IT Services, principally to take advantage of a placement at a discounted price in a stock we already own, Pioneer Credit Limited (PNC), which sits within Diversified Financials. The placement was completed at $2.00 and pleasingly the stock ended the month at $2.08.



Thanks again for your interest and support and I look forward to providing another update in early June on our performance during May. In the meantime, please don't hesitate to get in touch should you have any specific questions about the portfolio.

Kind regards,

Jonathan Collett

Principal

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Important Information