

Emerging Companies Fund

Monthly Update: May 2017



Dear Fellow Investors,

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

The Fund's performance during the month was broadly in line with the Emerging Companies Accumulation Index (XECAL), both of which were down 1.0% in May. However, it is again worth noting that since inception the Fund's return is -2.3% vs -12.0% for the XECAL, so its relative performance has been strong. More importantly, we remain very confident in our investment strategy, process and the outlook for the current portfolio and continue to see the recent broad-based share price weakness in emerging companies as a great opportunity for the patient and dispassionate investor.

Performance summary

	February	March	April	May	Since Inception
Saville Capital Emerging Companies Fund ¹	-3.2%	+2.6%	-0.6%	-1.0%	-2.3%
Benchmark ²	+0.4%	+0.4%	+0.4%	+0.4%	+1.5%
Relative Performance	-3.6%	+2.2%	-1.0%	-1.4%	-3.8%

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 1.0% during May, which was a very pleasing result given some of the headwinds we encountered. While our positions in Afterpay (AFY, +14%) and Melbourne IT (MLB, +19%) made strong positive contributions to the Fund's performance following significant announcements, this was offset by the combination of a substantial earnings downgrade from Murray River Organics (MRG), which we have now exited (albeit not before a 36% decline), and unexplained but material share price declines for National Veterinary Care (NVL, -9%) and McPhersons (MCP, -10%), which had been strong performers for the Fund prior to May. More importantly, we attended meetings with the management of both NVL and MCP at the end of May and the positive momentum and outlook for both businesses remains unchanged.

At the end of May, AFY announced that its underlying retail sales were c.\$165m for the past two months (vs c.\$145m for the entire 3Q), implying that its annualised underlying sales are now >\$1 billion. This was not only ahead of our and market expectations, but continues the incredible momentum within the business. Furthermore, it also announced that it has increased its Receivables Funding Facility with NAB from \$40m to \$200m, on improved pricing terms. Again, this increase was ahead of expectations and provides significant scope for execution of their growth plans over the next couple of years.

Earlier in the month MLB made a strategic and highly accretive acquisition of a business called WME Group for \$39m, a leading provider of search engine optimisation and digital marketing services to the SME market. The acquisition was largely funded by a 1-for-7 entitlement offer at \$2.10 in which we fully participated. The stock enjoyed a re-rating following the deal, closing the month at \$2.55, up almost 20% since it was announced.

Conversely, the earnings downgrade from MRG was very disappointing given that it was primarily driven by delays to the execution of operating efficiencies captured in its FY17 prospectus forecasts. Based on our meetings with the Company, of which we had three in the past six months, the impression given was that the timing and magnitude of the operating efficiencies were, if anything, conservative. Therefore, to see this contradicted had a significant impact on our view of the Company's credibility, hence we exited our entire position on the day of the announcement. MRG has subsequently issued another earnings downgrade (this time due to overestimating its harvest yield) and it has declined a further 45% since we sold, which further validates our decision to promptly exit when we did. Despite the issues it is experiencing, our long term positive investment thesis on its underlying business remains unchanged, however our confidence in their ability to execute has been severely damaged, particularly given its (now) stretched balance sheet.

Market commentary

The XECAI again experienced a negative month, declining by 1.0% in May, while the Small Industrials Accumulation Index (XSIAI) was even weaker, down 2.9%. We are currently seeing less share price action consistent with forced selling due to Fund redemptions, so we remain hopeful that the bulk of this activity has now washed through the micro/small cap market. Time will tell.

Company in focus: Shaver Shop Limited (SSG)

In this update we provide a summary of why we have SSG in the portfolio, which was down 3% in May, despite delivering another earnings upgrade at the end of the month.

SSG has 108 stores (95 Corporate, 13 Franchise) across Australia and New Zealand as well as a growing presence online (c.7% of sales). It has 28% share of the Personal Care Appliances market (worth \$510m), with reasonably high barriers to entry due to its significant store footprint, purchasing power and its exclusive product range (37 of its top 50 selling products). SSG is benefitting from structural growth trends (increasing vanity), product innovation from its suppliers, new store rollout and franchise store buybacks.

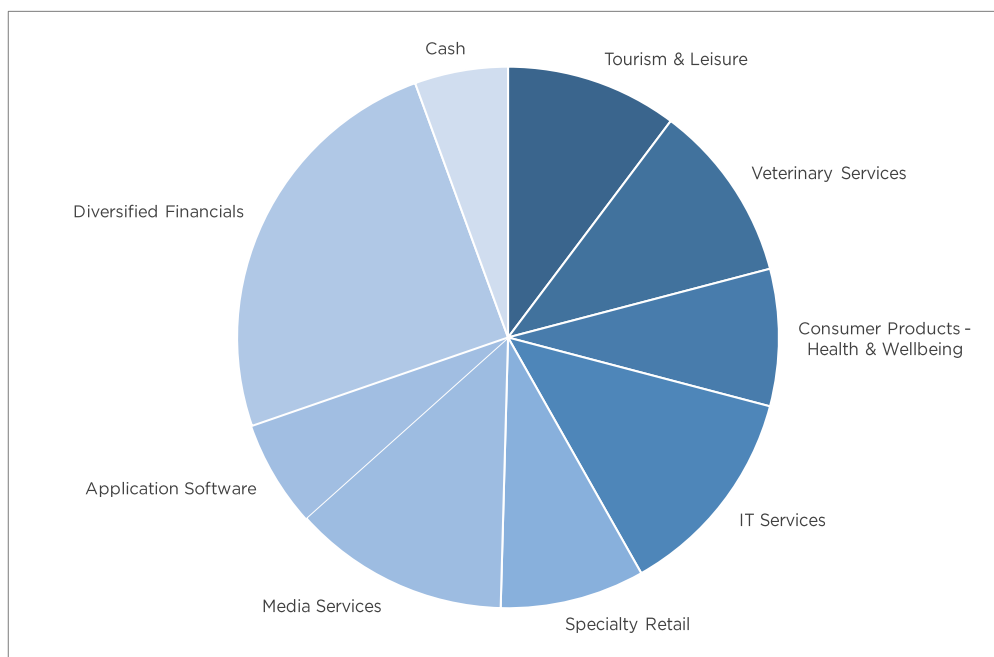
SSG has experienced a tumultuous period since its IPO in July 2016. During October 2016, SSG became the subject of an aggressive sell-off primarily due to a key shareholder suffering a significant redemption of their FUM, resulting in a virtual fire sale of their holdings, including SSG. This period has clearly damaged investor confidence in the stock, which when followed up with a material downgrade to its prospectus earnings forecasts in December, compounded the share price weakness such that it was down c.50% from its IPO price at the start of March, which is when we were building our investment position.

Since then, SSG has delivered two earnings upgrades, such that it is now on track to meet and perhaps exceed its original prospectus forecasts. Its like-for-like (LFL) sales have gone from being slightly negative during Jan/Feb to +20% in more recent months. Despite this, the stock is still trading almost 40% below its issue price and on an FY17 P/E multiple of just 9.2x with EPS growth of at least 10% in FY18 based on our forecasts. Unfortunately the difficult prevailing retail conditions, combined with fears over the impact Amazon will have on local retailers when it enters Australia, has seen the multiple the market is willing to pay for retail stocks significantly deteriorate over the past 12 months.

However, it is worth bearing in mind that the risk to SSG achieving its FY17 prospectus earnings has largely abated, it has undertaken more greenfield store openings and franchise buybacks than anticipated, the majority of its products are more expensive on Amazon and it now has an exciting new sales channel via Diagon sellers into China. Hence, in our view, had the now 'retracted' earnings downgrade never occurred, this stock would (and should) still be trading at a broadly similar multiple to when it listed (i.e. c.14x vs c.9x currently). We expect that further evidence of its robust earnings outlook into FY18 and beyond will drive a material re-rating of its share price over the next 6 to 12 months.

Portfolio characteristics

We currently have c.95% of our capital invested in 12 stocks, with the remainder held in cash. Since our last update, we have made a few changes to the portfolio. We have already discussed our exit from MRG, however our ongoing research activities also gave rise to some caution around the short to medium term earnings outlook for a couple of other companies to which the Fund was exposed. One example was Think Childcare (TNK), which owns and operates childcare centres. We decided to exit this position based on our view that incremental news flow on occupancy trends in the childcare industry are likely to remain negative and could further surprise on the downside over the next 6 to 12 months. While we are long term investors, we still must remain vigilant and nimble, reacting to prevailing trends that undermine our investment thesis and could cause a material share price derating in the short term.



Thanks again for your interest and support and I look forward to providing another update in early July on our performance during June, which I am pleased to say has experienced a solid start to the month. In the meantime, please don't hesitate to get in touch should you have any specific questions about the portfolio.

Kind regards,

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