Emerging Companies Fund

Monthly Update: November 2017

Dear Fellow Investors,

Our Emerging Companies Fund performed very well again in November. The Fund was up +9.5% vs +4.2% for the Emerging Companies Accumulation Index (XECAI) and +2.8% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund's absolute return is now +48.1% vs +6.5% for the XECAI and +3.7% for our cash-based benchmark.

Performance summary

	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Inception
Saville Capital Emerging Companies Fund[1]	-3.2%	+2.6%	-0.6%	-1.0%	+7.6%	+6.4%	+2.7%	+4.0%	+13.2%	+9.5%	+48.1%
Benchmark[2]	+0.3%	+0.4%	+0.4%	+0.4%	+0.4%	+0.4%	+0.4%	+0.4%	+0.4%	+0.4%	+3.7%
Relative Performance	-3.5%	+2.2%	-1.0%	-1.4%	+7.2%	+6.0%	+2.4%	+3.6%	+12.8%	+9.1%	+44.3%

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

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

Performance commentary

The Fund's performance was driven by strong contributions from at least half of our portfolio investments. The key contributors were BIG Un (BIG, +40%), Clover (CLV, +36%), Spirit Telecom (ST1, +30%), Melbourne IT (MLB, +24%), PolyNovo (PNV, +15%), HUB24 (HUB, +11%) and Think Childcare (TNK, +8%). We also added a few new stocks to the portolio this month, with the most notable being Longtable Group (LON), which undertook a $43m placement to fund the acquisition of B.-d. Farm Paris Creek, one of Australia's largest organic-biodynamic food and beverage businesses. The stock finished the month up >100% from the placement price, however the impact on the portfolio's performance won't be captured until the December NAV as we don't officially take receipt of the shares until the placement is granted shareholder approval on 19 December.

BIG made several announcements, including 2Q FY18 cash revenue guidance of >$20m (+33% on 1Q FY18) and an update on its US operations, suggesting its volume and revenue is tracking comfortably ahead of our forecasts. Nonetheless, with the stock rallying very strongly again (it was up 67% intra-month at one point) and rapidly advancing towards our valuation, we took the opportunity to halve our position. As such, our exposure to BIG is now below the average weighting within the portfolio, which we think is prudent given the euphoric rise in its share price over recent months. This decision has arguably since been validated given the extreme levels of share price volatility we observed in the last week of November, during which time it oscillated +/-10% on multiple different days. We note that its practice of periodically issuing stock for services rendered, often at very deep discounts to the prevailing share price, is a likely driver of this volatility.

PNV provided some upbeat commentary at its AGM, noting that sales of its NovoSorb BTM have doubled since September (total YTD sales at $750k) with several hospitals having made repeat orders (one hospital has ordered four times since September). Furthermore, the Company stated that it anticipates orders to build significantly between now and year end, with the expectation that they "will double again before year end and perhaps double again". The Company also stated that it has "broken the back of market penetration and it is no longer a matter of if orders will flow but when". Having met with management again during November, we continue to view PNV as one of the most exciting companies within our portfolio.

Conversely, we decided to exit our position in Pioneer Credit (PNC). This was largely driven by a lack of valuation support given the stock was trading above $3.00 vs our valuation of $3.15, but compounded by the fact that its CEO and Founder, Keith John, sold c.20% of his total holdings (reducing his stake in the Company from 12.74% to 10.07%) at a discounted price of $2.85. While he still has more than sufficient alignment of interests, given his decision to sell a material amount coincided with our own view that the stock price was approaching fair value, this catalysed our decision to exit PNC entirely. We first bought PNC at $2.05 during February, so with an average exit price of $2.93, we generated a very healthy 50% return (including dividends) over that period.

We also exited our position in Afterpay (APT), again primarily due to lack of valuation support at current levels. Our valuation was $6.30, so we started actively reducing our position in the stock in October at above $5.50 and this continued into November. We also noted with interest that in its last presentation, the Company gave a range for its Net Transaction Loss of 0.6% to 1.0%, albeit commenting that it is “seasonal”. This is a key driver of value for APT and the fact that it has moved from being 0.6% in 2H FY17 to what is quite a large possible range in 1Q FY18 gave us some minor cause for concern. As such, we took the decision to exit the stock entirely and bank what has been a significant positive contributor to the Fund. We first bought a position in APT at $2.34 in April and had an average exit price of $5.57, resulting in a 138% return over the past eight months.

Company in focus: Clover Corporation Limited (CLV)

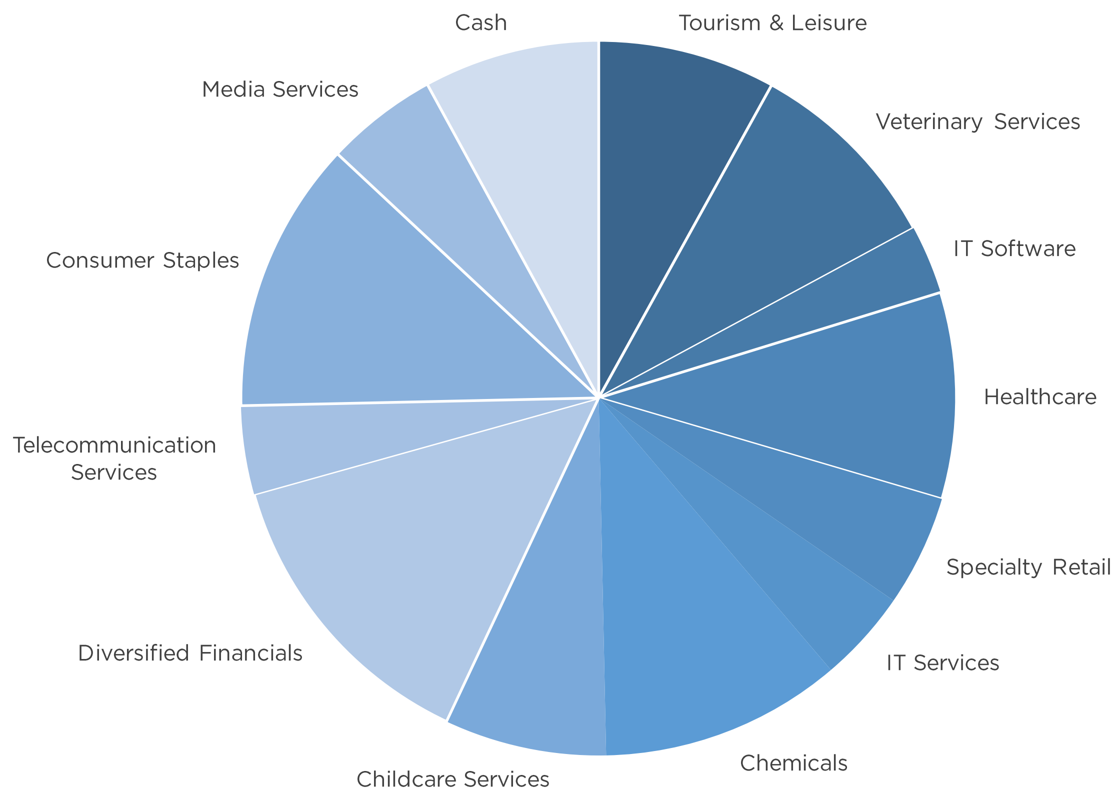
CLV is involved in the refining and sale of omega-3 oils and encapsulated bioactive ingredients for infant formula, children’s foods, supplements and medical foods. Its primary source of revenue is utilising its patented technology to remove the taste and odour from HiDHA tuna oil, a source of omega-3 docosahexaenoic acid (DHA), before it is blended with the other ingredients which comprise infant formula. Its two largest customers are Danone (31% of sales) and A2 Milk (15% of sales), both of whom are significant and growing players in the global infant formula market, particularly in China. In 3Q CY17 alone, Danone’s infant formula sales grew by >20% and A2 Milk’s grew by >70%, suggesting that CLV’s sales in FY18 would also be experiencing strong growth. In addition, the medium term growth outlook for CLV’s ingredients will be underpinned by the mandatory level of DHA within infant formula sold in Europe increasing from 10mg to 20mg (for every 100 kcal) from 2020 onwards. We would not be surprised to see these guidelines adopted in other parts of the world also (e.g. China/North America).

Furthermore, CLV’s gross margins are improving as it revisits contracts with key customers that, in many cases, were renegotiated during a period of weak demand for Australian and New Zealand infant formula due to a botulism scare involving Fonterra (i.e. unrelated to CLV) in August 2013. As a result of this, CLV’s gross margins declined to a trough of 20.2% in FY15 (after averaging 38% from FY10 – FY13) but are now steadily improving, having achieved 24.2% in FY17. We expect this positive trend to continue over the next few years, with a longer term target of returning to 35%. This seems entirely reasonable given CLV provides a critical ingredient for infant formula companies (which themselves earn gross margins of 45-65%) and has significant market share in its segment.

We are also attracted to the growth options with CLV’s business, most notably its potential to sell its DHA product to sports’ drink manufacturers, which we understand could represent a $50m revenue opportunity (note that CLV only generated $47.9m total revenue in FY17). In fact, CLV is currently in negotiations with a US sports’ drink company with a view to potentially signing a contract before the end of FY18. In our view, CLV has a strong management team, conservative balance sheet (it is net cash) and a positive short and long term earnings outlook driving a rapidly improving return on capital. We also note with interest that Bega Cheese (BGA) sits on CLV’s share register with a 1.2% holding. We have derived a DCF valuation for CLV of $0.90 (vs current share price of $0.70 and our average entry price of $0.59) based on conservative assumptions. We first bought CLV in October and believe it has the potential to be a great long term investment for the Fund.

Portfolio characteristics

We currently have c.89% of our capital invested in 15 stocks, with the remainder held in cash. We added three new positions to the portfolio during November which we will discuss in subsequent versions of our monthly update.



Thanks again for your interest and support and I look forward to providing another update in early January on our performance during December. As always, please don't hesitate to get in touch should you have any specific questions about the portfolio. **In the meantime, I hope you have a Merry Christmas, Happy New Year and safe holiday period**.

Kind regards,

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Important Information