Emerging Companies Fund

Monthly Update: March 2018

SAVILLE CAPITAL

Dear Fellow Investors,

Our Emerging Companies Fund delivered another month of strong performance, especially when compared against the key indices. The Fund was up +1.6% vs -3.8% for the Emerging Companies Accumulation Index (XECAI) and -1.7% for the Small Industrials Accumulation Index (XSIAI). This was a very pleasing outcome given the ongoing levels of market volatility being observed locally and abroad. Nonetheless, the Fund is certainly not immune, with plenty of stocks within the portfolio suffering material declines during the month. In fact, a short term market derating is often exacerbated among the smaller, less liquid, stocks as some investors inevitably panic and seek to exit at almost any price until sufficient liquidity is found. While this creates opportunity for the dispassionate investor, it can certainly impact short term performance. Since inception the Fund's return is +66.6% vs +10.8% for the XECAI, +14.5% for the XSIAI and +5.2% for our cash-based benchmark.

Performance summary

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2017		-3.2%	+2.6%	-0.6%	-1.0%	+7.6%	+6.4%	+2.7%	+4.0%	+13.2%	+9.5%	+8.1%	+60.1%
2018	-1.6%	+4.2%	+1.6%										+4.2%

Returns are net of all base fees, performance fees and expenses of the Fund

Performance commentary

The highlight of the month was Clover (CLV, +36%), which reported a very strong 1H FY18 result, delivering revenue growth of 60% and NPAT growth of 209% on pcp, ahead of our forecasts and well ahead of those of its sole coverage broker. This was driven by a combination of improved demand from its key infant formula customers and expanding gross margins (27.5% vs 24.2% in pcp) due to the ongoing renegotiation of key customer contracts. While we had anticipated these developments and factored them into our forecasts, the timing and quantum exceeded our expectations. Interestingly, as noted above, the stock was up 36% for the month, however it had actually declined significantly leading into the result such that it is actually up over 50% since it reported.

This was a very pleasing result for the Fund as not only was CLV our largest position within the portfolio at the end of February, we actually added to the position leading into the result, capitalising on what we perceived to be unjustified and irrational share price weakness. We also think it validates our high conviction and concentrated approach, ensuring that we maximise the benefits that come from our research and analysis.

The other positive contributors for the month were Lovisa (LOV, +10%), Axsesstoday (AXL, +8%), Polynovo (PNV, +5%) and Tourism Holdings (THL.NZ, +3%). Conversely, we had several significant negative contributions from the stocks we own, including Phoslock (PHK, -16%), Longtable Group (LON, -11%), National Veterinary Care (NVL, -8%) and Think Childcare (TNK, -7%). While the share price declines are unfortunate, we do take some comfort from the fact that none of these declines were accompanied by any negative announcements from the companies. In fact, in the case of TNK, it actually announced the acquisition of four childcare centres for $5.7m, representing a 4x EBITDA multiple, which it funded through a $10m institutional placement (in which we participated). Furthermore, it reaffirmed its earnings guidance for CY18, implying that it is trading on a CY18 P/E multiple of just 12x, despite strong industry tailwinds due to arrive from July onwards when the new childcare funding scheme is implemented.

We exited our investment in MLB during the month, principally to help fund the addition of a new stock to the portfolio which we will discuss in a subsequent monthly update. MLB had been a strong performer for the Fund, having risen from our initial entry price of $2.15 in February 2017 to our average exit price of c.$3.30 in March 2018, implying a gain of 61% after accounting for dividends paid. We are still attracted to MLB's solid earnings outlook, hence we will remain interested observers, but for now we have decided to transition our investment into what we see as a more attractive proposition at current prices.

Company in focus: Axsesstoday Limited (AXL)

AXL provides equipment leasing solutions primarily in the Australian hospitality and transport sectors, enabling SMEs to purchase business critical equipment. The hospitality equipment items it finances include coffee machines, commercial ovens, dishwashers and refrigerators, while the transport items include prime movers, vans, trailers, tankers and refrigerated trucks. AXL is integrated into >450 merchants' POS systems offering leases of up to five years in length and $500k in size, albeit on average leases are <$25k.

AXL's key point of differentiation is that it can provide finance at the retail POS under either a white label or branded product with real-time credit approval through a streamlined online portal. As a consequence, the purchase and finance approval process can be completed within minutes (vs days for many incumbents), delivering a simplified outcome for both the merchant and consumer, while still ensuring AXL manages its credit risk effectively under a highly scalable solution.

Importantly, despite provisioning upfront for loss rates of 2.5%, AXL's actual loss rates are running at just 1.6% due to a strong focus on diversification (69% of accounts are less than $25k, distributed all across Australia) and risk management (AXL requires both security over the asset and a personal guarantee from the borrower). In addition, AXL only focuses on what it refers to as "cookie-cutter" businesses (e.g. suburban cafés) that are less exposed to the economic cycle and therefore more likely to be able to meet their interest and repayment obligations during an economic downturn.

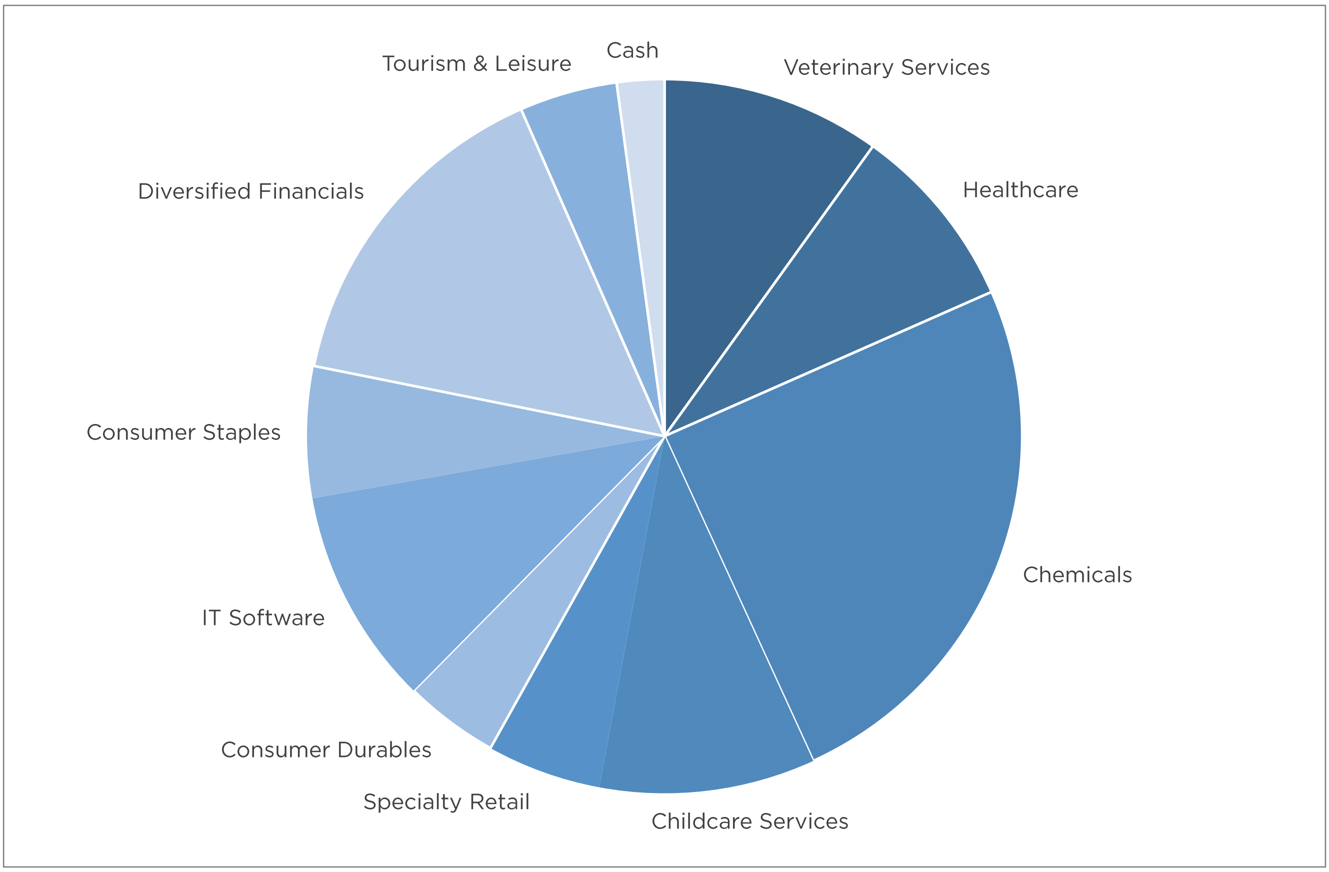
AXL is benefitting from a continual (and somewhat deliberate) structural shift away from bank leasing. From 2000 to 2017, the Australian banks' share of a growing leasing market has declined from 46% to 34% with 'other lessors' (including AXL) growing to 28% of the market, up from 8%. AXL has funded its leasing book through a combination of senior syndicated bank debt (MQG & CBA), corporate notes on issue and equity. However, it has just announced the establishment of a new $200m securitisation warehouse facility that will not only reduce its funding costs (currently c.7%) and future equity requirements, but also help to underpin further strategic growth into the future.

We expect AXL will continue to generate strong growth (loan book is currently growing at c.$5m per week) via further penetration of its existing verticals and merchant customers, as well as entering new verticals and markets (such as Canada where it has recently launched a pilot operation). Furthermore, this revenue growth should be combined with solid margin expansion as the Company is already structured to manage significantly larger loan volumes than it currently supports.

Based on our own detailed modelling, we have arrived at a DCF valuation of $2.95 (vs our initial entry price of $1.85 and current share price of $2.05) which is based on AXL reaching a loan book of c.$900m (vs $256m as at 31 December 2017) within the next decade combined with further margin expansion as a result of improving terms with its financiers and natural operating leverage within the business, particularly given the scalability of its solution. Its near term capitalisation multiples are also undemanding given it is trading on a c.11x FY19 P/E despite offering a forecast 3yr EPS CAGR of 27%.

Portfolio characteristics

We currently have 98% of our capital invested in 12 stocks, decreasing our cash weighting to 2% in order to capitalise on some of the purely sentiment-driven declines among a few of the stocks we own. As mentioned, we sold one stock during the month, but replaced it with another investment which we will discuss in a future monthly update.



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

Kind regards,

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Important Information