Emerging Companies Fund

Monthly Update: January 2020

SAVILLE CAPITAL

Dear Fellow Investors,

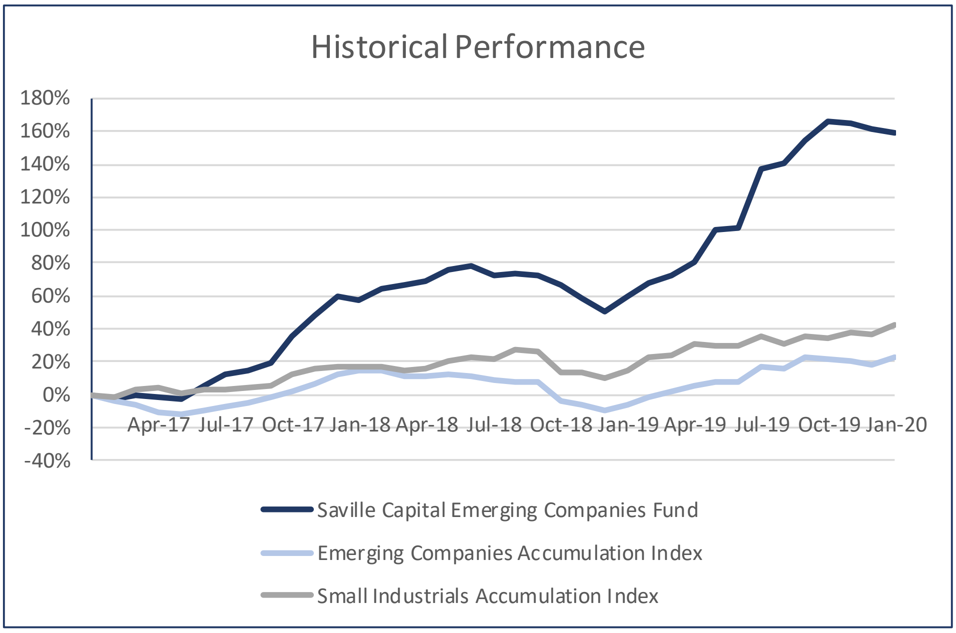
Our Emerging Companies Fund was down -0.6% in January vs +3.5% for the Emerging Companies Accumulation Index (XECAI) and +4.1% for the Small Industrials Accumulation Index (XSIAI). Since inception the Fund is +159.3% (assuming distributions are reinvested) vs +22.5% for the XECAI, +42.0% for the XSIAI and +13.1% for our cash-based benchmark.

January saw a continuation of the trend we observed towards the end of 2019, where stocks we own that sit within the genuine microcap end of the market (i.e. market cap of <$100m) continued to suffer from selling pressure. As noted last year, we think this trend started as a result of transition flows driven by large super funds withdrawing money from external microcap fund managers. However, we believe that has now largely played out and that this latest round of selling is retail investors simply following the negative momentum, which still has a solid impact given the lack of liquidity in some of these stocks. While it can be frustrating to watch, it's actually a long term positive for the Fund as this share price action isn't just confined to those smaller stocks we own, so it is now presenting new opportunities in stocks that we previously researched and liked, but deemed too expensive to buy at the time. Meanwhile, stocks with greater size and liquidity are generally moving yet higher on positive share price momentum, a situation we are happy to avoid chasing. Taking a longer-term view, we remain very confident in our current portfolio of stocks and are comfortable riding out this period of modest weakness while we look for new opportunities to invest our large cash balance.

Performance summary

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total	3M	12M
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%	+1.1%	+4.1%	+1.6%	-3.1%	+0.7%	-0.8%	-3.2%	-4.8%	-5.2%	-5.9%		
2019	+6.0%	+4.8%	+3.1%	+4.7%	+10.8%	+0.6%	+17.6%	+1.4%	+6.1%	+4.6%	-0.8%	-1.3%	+73.2%		
2020	-0.6%												-0.6%	-2.7%	+62.4%

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



Performance commentary

The key positive contributors for January were Pointsbet (PBH, +16%), Polynovo (PNV, +42%) and Carbon Revolution (CBR, +6%). Conversely, the key negative contributors were RBL (-9%), Bluechiip (BCT, -13%), Tourism Holdings (THL.NZ, -13%), Terragen (TGH, -20%) and Rhinomed (RNO, -14%).

A number of our stocks reported their quarterly cash flow figures during late January, with the only real surprise being a much softer revenue result for BCT due to some logistical issues at one of its contract manufacturers. BCT had already flagged to the market that as part of its recent capital raising it would be making some changes to its supply chain, so the reasoning behind the revenue setback appears valid given the circumstances. We understand that these supply issues are now behind BCT and its focus remains on securing new licence agreements for its technology, which we hope to see signed during 2020. Importantly, cash receipts were again solid, reinforcing that Labcon is paying BCT in a timely manner and remain committed to maintaining (and growing) their relationship.

PBH delivered a very strong 2Q FY20, with the highlight being the significant improvement in its Australian business, despite the mature and competitive nature of that market. Within Australia, PBH recorded an impressive 76% increase in Net Win on the pcp and increased its Net Win Margin to 7.9%, up from 7.5% in the pcp. While the long-term growth engine for PBH is clearly the opportunity in the US, the Australian results remain important because it not only demonstrates their operating credentials, but it can also be a source of funding for their growth plans overseas. Meanwhile, in the US market, PBH achieved its first positive Net Win Margin in a quarter at +3.0%, demonstrating that it can still produce positive results in an environment where its key focus is on using promotional spend to acquire and retain clients. Market share in New Jersey was 5.9%, down from 6.7% during the previous quarter, due to some more subdued activity from its High Staking Clients. Nonetheless, we still see this level of market share as very encouraging given some of the unique characteristics of New Jersey, particularly the significant advantage enjoyed by the incumbent fantasy sports operators, that have since become large bookmakers (with dominant market share) in that state. Finally, PBH also announced market access agreements to enter into the states of Michigan and Kansas, contingent upon obtaining the necessary regulatory licences, thus continuing to build its US footprint.

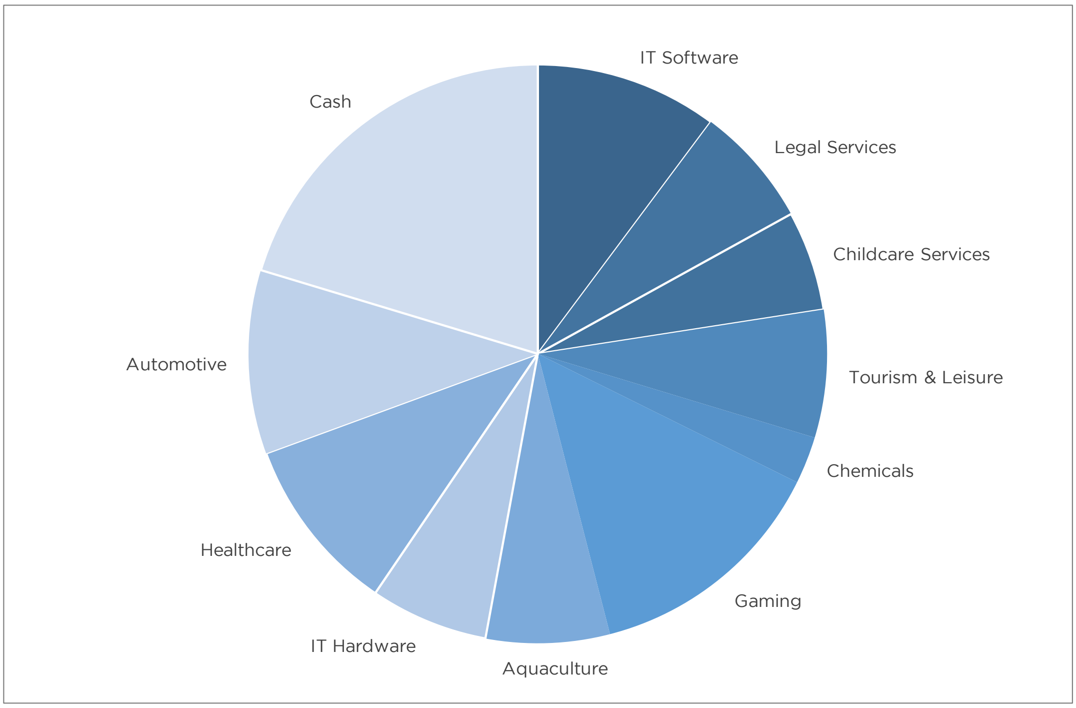
Generally speaking, the quarterly results from our other stocks were broadly in line with our expectations. Bearing in mind that stocks such as Carbon Revolution (CBR), Murray Cod Australia (MCA) and Terragen (TGH) are still at a very early stage in terms of their long-term potential and as such we aren't expecting instant gratification in terms of rapid earnings or share price growth. These are businesses which, in our view, have outstanding products operating in very large addressable markets, but also understand the importance of growing their businesses in a measured and responsible manner. As patient long-term investors, we are aligned with that approach and don't need a near term spike in earnings or share price to maintain or justify our ongoing support of the company.

In other news, fortunately we capitalised on the share price strength in Sealink (SLK) during the December quarter of last year to largely exit our position in the stock, the remaining shares of which we sold during January. Our average exit price across that period was $4.90 vs its current share price of $4.06 and placement price of $3.50 in October 2019 (when we significantly added to our position). SLK has been under pressure due to the impact of recent bushfires and the Coronavirus containment measures. Given most of the selling was done prior, our reason for exiting the stock certainly wasn't in response to these issues (albeit the timing was fortuitous), it was driven by valuation and our view that the risk/reward equation had tilted against holding the stock any longer.

However, we do still retain exposure to tourism via our investment in Tourism Holdings (THL), which has also been under pressure due to the reasons cited above, albeit we have used that share price weakness to increase our investment. The reason being is that THL's geographic exposure is more diverse (Australia, New Zealand and United States), it was already very cheap due to the transient impact of an oversupplied motorhome market in the US, and we still see great long-term potential for the business, which we believe is being undervalued by the market. Unsurprisingly, THL provided an update to the market during January in which it forecast that its FY20 NPAT will be around NZ$24m vs consensus at NZ$32m (this figure hadn't been updated for the recent negative events). THL cited the previously disclosed USA vehicle sales weakness, the Australian bush fire cancellations and forward booking reductions and a forecast reduction in Chinese inbound customers over the next two months due to the Coronavirus containment measures as the reasons for the downgrade.

Portfolio characteristics

We currently have ~82% of our capital invested in 12 stocks.



Please get in touch should you have any queries regarding the above. Thanks again for your interest and support and I look forward to providing another update in early March on our performance during February.

Kind regards,

Jonathan Collett

Principal

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