Emerging Companies Fund

Monthly Update: September 2020

Dear Fellow Investors,

Our Emerging Companies Fund was up +3.1% in September vs -1.0% for the Emerging Companies Accumulation Index (XECAI) and -2.3% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund is +294.1% (assuming distributions are reinvested) vs +28.1% for the XECAI, +28.8% for the XSIAI and +15.3% for our cash-based benchmark. On an annualised basis, the Fund has generated a return of +45.4% p.a. since inception.

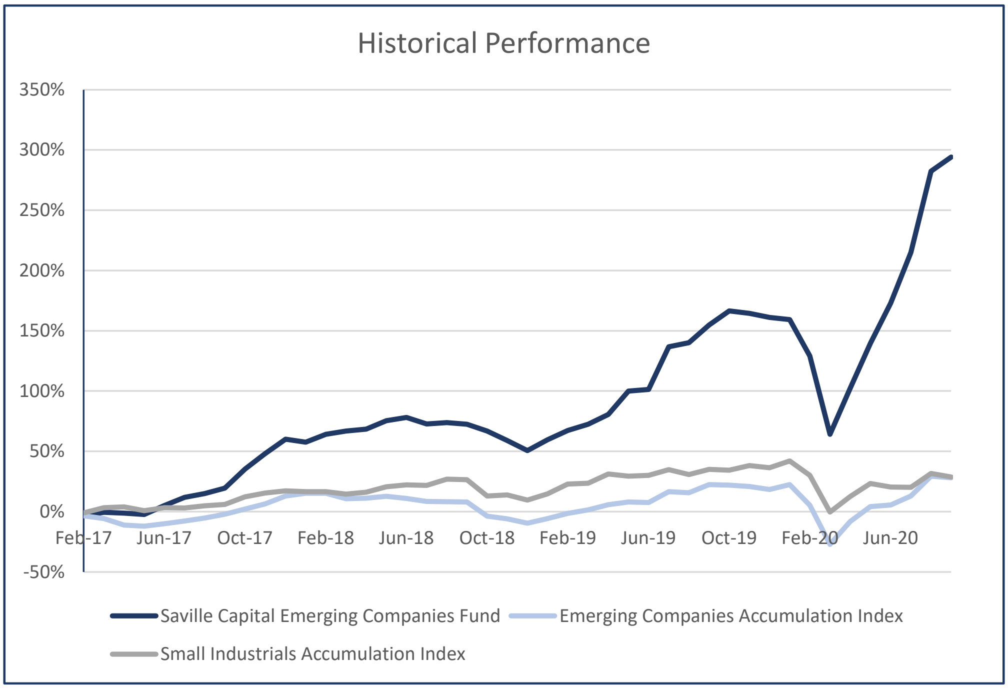
Despite a more challenging month for markets, our Fund still managed to record solid gains, largely driven by some of the smaller stocks in the portfolio that had been notable laggards in recent months. We also made a few additions to the Fund which had an immediate positive impact, albeit we expect this will grow into a much larger performance contribution as our investment thesis in each of those stocks plays out over time.

As previously flagged, due to the strong recent performance and steady inflows we closed the Fund to new investment at the end of September. We now have 20 companies in the portfolio and feel confident about the level of potential growth these investments can generate, balanced by our desired level of diversification. While markets will continue to have an influence on our short-term performance, the quality of this portfolio gives us optimism about our ability to continue to deliver solid long term returns for the Fund.

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%	-11.7%	-28.4%	+23.3%	+18.4%	+14.1%	+16.0%	+20.7%	+3.1%				+51.0%	+44.3%	+54.7%

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



Performance commentary

The three largest positive contributors for September included a recent addition, Imricor (IMR, +62%), as well as Terragen (TGH, +29%) and Redbubble (RBL, +6%). The only material negative contributor was Marley Spoon (MMM, -20%).

After floating at $0.25 in December 2019, TGH saw consistent share price declines until reaching a bottom of $0.08 in late March. None of this was driven by news flow, in fact TGH has continued to deliver strong sales growth since listing. It appeared to be a simple case of negative share price momentum feeding on itself, which was compounded by its lack of liquidity. We built our initial position via the IPO, but have steadily added to our holdings since then, therefore it was pleasing to see it finally move back up above its IPO price during September, finishing the month at $0.33. Apart from the CEO buying some stock on-market, there was no specific news flow during September, however we think that the market is finally waking up to the potential of TGH's products (particularly *Mylo*) and commercialisation strategy, led by a highly capable board and management team.

While guidance had already been recently upgraded, Tourism Holdings (THL.NZ, +7%) reported a very pleasing FY20 result in the context of the headwinds it has faced over the past six months. Demand for rental of its motorhomes has clearly been significantly impeded, but the sale of motorhomes has seen a surge in demand as people prepare for holidays where they can largely control their own environment and thus minimise the risk of infection with COVID-19. The added benefit for THL has been that these sales have significantly reduced its debt position during a period of much lower rental earnings. With the US market largely re-open and Australia/New Zealand moving towards more porous state and national borders, we are optimistic that THL can rebound quite sharply from the effects of lockdown during CY21.

Micro-X (MX1, +24%) surged late in the month following the announcement that it had signed its first contract ($1.4m) for sales of its Rover X-ray units. The contract was facilitated by the World Health Organisation (WHO) for delivery to Governments of several Pacific Island nations. These sales are significant for two reasons: firstly, Rover is a much higher margin product for MX1 as it is being sold directly to customers instead of via an OEM model; and secondly, the Rover is largely targeting military customers in the Australian, US and UK armed forces, so to achieve sales outside of those specific categories is not only a bonus, but indicative of its potential to tap into a wider market.

As mentioned in our August Update, one of the best results we reviewed among our portfolio during reporting season was from Pro-Pac Packaging (PPG, +20%). So it was pleasing to see the delayed recognition of this during September, perhaps catalysed by the on-market share purchases by the CEO and one of the Board members. Another stock we added to the portfolio during September was Lark Whisky (LRK, +23%), via a $8.5m placement at $1.10/share. Lark produces premium single malt whiskey and gin from its distilleries in Tasmania, led by a very strong Board/management team with significant industry experience/credibility for such a small company. Net sales are forecast to increase by 100% in FY21, driven by expanding its suite of products within its target categories, monetisation of its maturation asset and diversifying its distribution footprint.

With regard to the disappointing share price performance of MMM during September, this came as a surprise given the Company only upgraded its CY20 revenue guidance from "at least 70% growth" to "80% to 100% growth" at the end of August. However, we think its recent share price decline is largely being driven by an excess supply of shares available for sale following the recent conversion of subordinated debt into equity. In addition, like other structural winners from lockdown, we believe the market remains somewhat sceptical that the recent level of sales can be sustained into late CY20 and beyond, let alone see growth once we are cycling these higher comps. As such, we will have to await further earnings updates to validate our view that many of the changes in consumption habits observed during lockdown will persist in the aftermath. Notably, we are yet to see any significant reversion of consumer behaviour in markets that have exited lockdown.

Company in focus: Murray Cod Australia Limited (MCA)

Murray Cod Australia (MCA) was established in 2017 to create a revolutionary land-based aquaculture business that farms and cultivates the indigenous species of Murray Cod as a food source. MCA's operations are based in the NSW Riverina region (headquartered in Griffith), an area famous for local produce, with sales spanning across the globe. It sells its Murray Cod under the AQUNA brand – derived from the word "Akuna" (an aboriginal word meaning "the way forward" and "flowing water"). MCA's product is differentiated from its competitors through its sustainable land-based aquaculture practises that lead to a clean, white and fatty flesh that has a mild taste, while offering a clean source of protein and Omega-3. It can be cooked in a variety of ways including grilled, steamed, fried, baked, barbecued, seared, boiled or eaten raw (e.g. sashimi). Given the depleted stock levels in the river systems, commercial fishing of Murray Cod is no longer permitted. Furthermore, the hatchery business is regulated/licensed, with MCA owning the largest supply of fingerlings, so the barriers to entry for new entrants are quite significant.

Given its superior taste and texture, Aquna Cod is sold as a premium fish, as evidenced by its wholesale price of $23-$25/kg vs Barramundi at $8-$10/kg and Salmon at $12-$14/kg. While historically it has sold most of its product to restaurants (both domestic and overseas) via distributors, the onset of COVID-19 has forced the Company to pivot towards domestic retail sales. Even with COVID, we see this as a natural evolution for the Company, given that as it scales production it will need to broaden its sales and distribution channels via national supermarket chains and meal kit suppliers.

Thus far, MCA has managed to leverage high profile chefs, such as Heston Blumenthal (global celebrity chef with a three Michelin star restaurant, The Fat Duck), to help market its product. In 2019, and driven by inbound interest, The Fat Duck group signed a five-year agreement with MCA in which Blumenthal would act as a key advocate. It was also announced that he would undertake partial ownership in the Company via the issue of 1.5m shares. Blumenthal states that he was attracted to the opportunity due to the "innovative way they have created a luxury fish product… resulting in fantastic quality". MCA's product has also made appearances on MasterChef Australia, with Gordon Ramsay recently developing a dish centred around Aquna Cod.

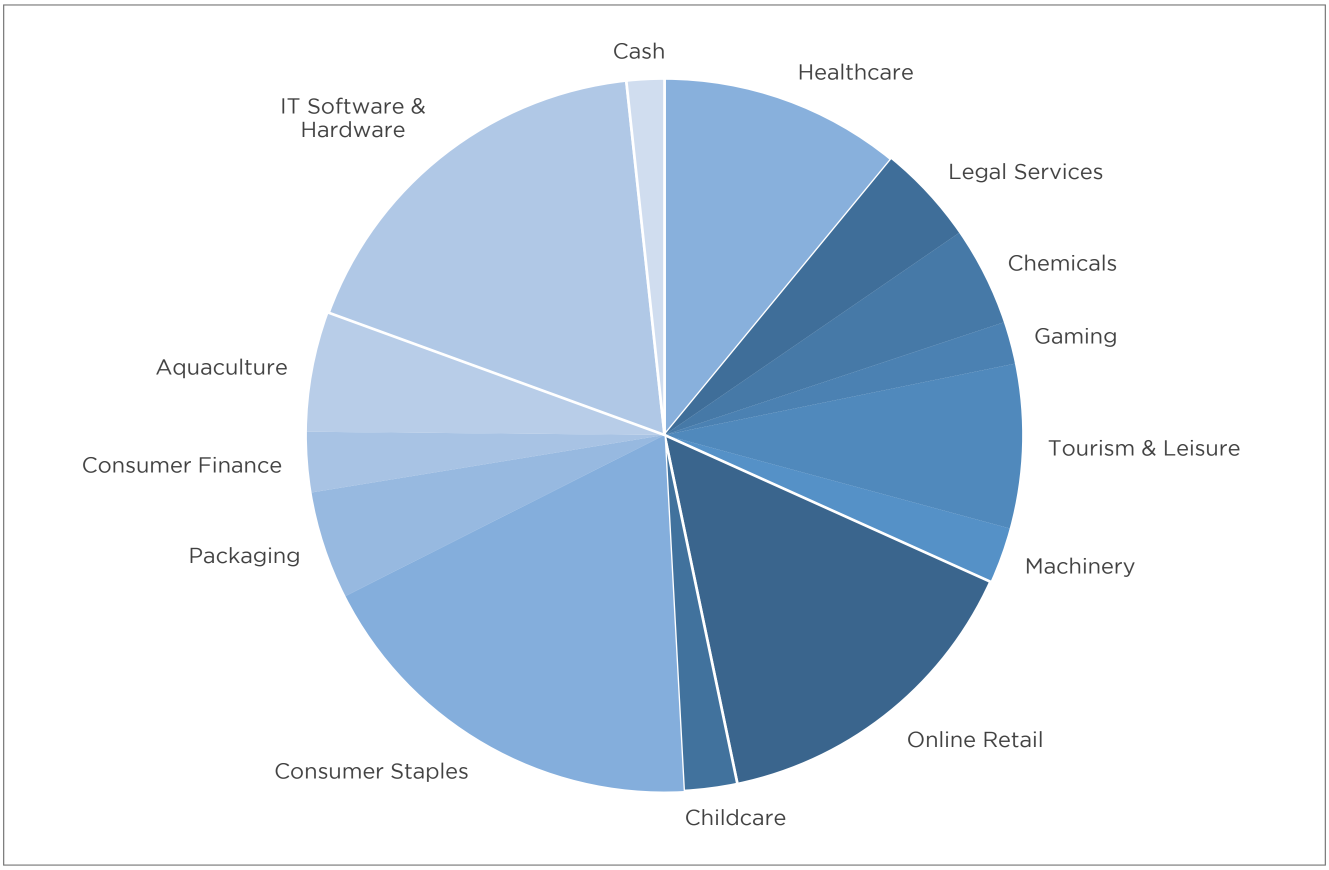
When compared to traditional aquaculture producers, MCA does not suffer from the common risks as MCA raises its fish in ponds, rather than the ocean, mitigating the risk of seals, sharks, broken nets and inclement weather. This benefits restaurants as it enables MCA to provide consistent supply assisting chefs to plan menus, while also ensuring that fishmongers and supermarkets have a reliable level of supply for their customers. This is a clear competitive advantage against other premium fish and helps to underpin its pricing.

MCA has significant runway ahead of it given its low market penetration relative to total seafood consumption. In Australia alone, MCA's sales would represent less than 0.1% of total seafood sales. As a point of comparison, in FY19 MCA sold 110 tonnes vs barramundi sales of >20,000 tonnes in Australia, over half of which was imported, mainly from SE Asia. On that basis, we are comfortable that as MCA increases its supply (it has production capacity of over 1,000 tonnes, increasing to 10,000 tonnes by 2030), it will be satisfied by demand, both locally and overseas (note ~25% of sales were via exports pre-COVID).

We acquired our initial stake in MCA at $0.145 in December 2019 to help fund the acquisition of a new hatchery (increasing production capacity by 2.5x) and its working capital requirements (it takes around 18 months before the fish are harvested for sale). We see MCA as a great long-term investment with only modest risk that it won't be able to realise its full potential. Assuming MCA can be producing 10,000 tonnes of fish by ~2030 at an average sale price of $25/kg and existing gross margins of ~50%, this is a business that could eventually be generating ~$125m of gross profit with minimal overhead (was only ~$5m in FY20 and the business is very scalable) vs its current enterprise value of <$100m. While further capital will be required to achieve these targets, the business is capital light in terms of infrastructure, so the incremental return metrics are compelling.

Portfolio characteristics

We currently have ~98% of our capital invested in 20 stocks, having added three new stocks during the month.



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 November on our performance during October.

Kind regards,

Jonathan Collett

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