

# Emerging Companies Fund

Monthly Update: February 2021



Dear Fellow Investors,

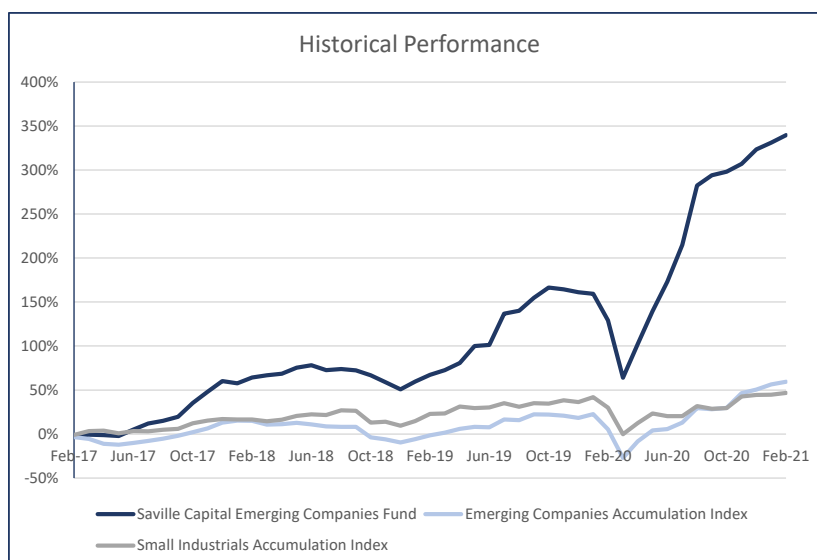
Our Emerging Companies Fund was up +2.1% in February vs +2.0% for the Emerging Companies Accumulation Index (XECAI) and +1.4% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund is +339.7% (assuming distributions are reinvested) vs +59.4% for the XECAI, +46.8% for the XSIAI and +16.6% for our cash-based benchmark. The Fund has generated a return of +43.8% p.a. since inception.

February was another solid month for the Fund, albeit with a significant increase in market volatility. The Emerging Companies Index was up almost +9% by the middle of February, before dropping sharply to finish at +2%. Unsurprisingly, the trend has continued into early March, with the key driver being ongoing concerns over the recent sharp increase in long term bond yields. While yields remain very low in absolute terms, the market is grappling with what a sustained increase might mean for equity valuations, particularly for growth stocks trading on high multiples of revenue/earnings. Consistent with our approach to macro factors, we haven't adopted a definitive view on whether the trend will continue, therefore it doesn't have any impact on our portfolio management or stock selection. However, it is worth highlighting that we have never been seduced into valuing stocks on prevailing rates, instead we always use a 5% risk free rate in our DCF valuations vs the current 10-year bond rate of ~1.8%. As an example of this, our current DCF valuation of MMM is \$6.00, however if we reduce the risk-free rate to 1.8% then it increases to \$10.50, and we could cite numerous other examples from our portfolio. In our view, none of our current stocks are being priced based on spot bond rates, and those that reach or exceed our valuation due to the use of lower rates and/or grandiose forecasts, we always sell.

## Performance summary

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total	3M	12M
<b>2017</b>		-3.2%	+2.6%	-0.6%	-1.0%	+7.6%	+6.4%	+2.7%	+4.0%	+13.2%	+9.5%	+8.1%	+60.1%		
<b>2018</b>	-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%		
<b>2019</b>	+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%		
<b>2020</b>	-0.6%	-11.7%	-28.4%	+23.3%	+18.4%	+14.1%	+16.0%	+20.7%	+3.1%	+1.0%	+2.3%	+4.0%	+62.3%		
<b>2021</b>	+1.9%	+2.1%											+4.0%	+8.1%	+92.3%

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



## Performance commentary

The three largest positive contributors comprised Marley Spoon (MMM, +24%), Lark Distilling (LRK, +21%) and Murray Cod Australia (MCA, +11%). The three largest negative contributors were Redbubble (RBL, -24%), Class Limited (CL1, -9%) and Imricor (IMR, -5%).

RBL reported strong revenue growth for 2Q FY21 (+84% on pcp, +96% constant currency) however it disappointed on its GPAPA margins (25% vs 34% in 1Q FY21) due to a combination of significantly increased demand for express shipping (these additional costs are largely absorbed by RBL), reduced masks sales and much higher paid marketing. While we expected some of this margin decline due to normal seasonal factors (notably unfavourable product mix and increased marketing initiatives) that are observed during the Thanksgiving/Xmas trading period, the extent of the decline was surprising, resulting in an EBITDA for the period that was below 1Q (despite revenue being 39% higher QoQ). Unfortunately, it was yet another example of RBL following a short period of strong operational performance with a disappointing result (some of which was within its control). Nonetheless, the underlying momentum in the business remains very strong, its level of cash generation and balance sheet are exceptionally healthy and it still has significant runway for growth via more targeted customer acquisition, optimisation of existing customer relationships, expanded product range and improved product quality. With a highly regarded new CEO now at the helm, we remain of the belief that more consistent execution will lead to a significant unlocking of value over the next few years.

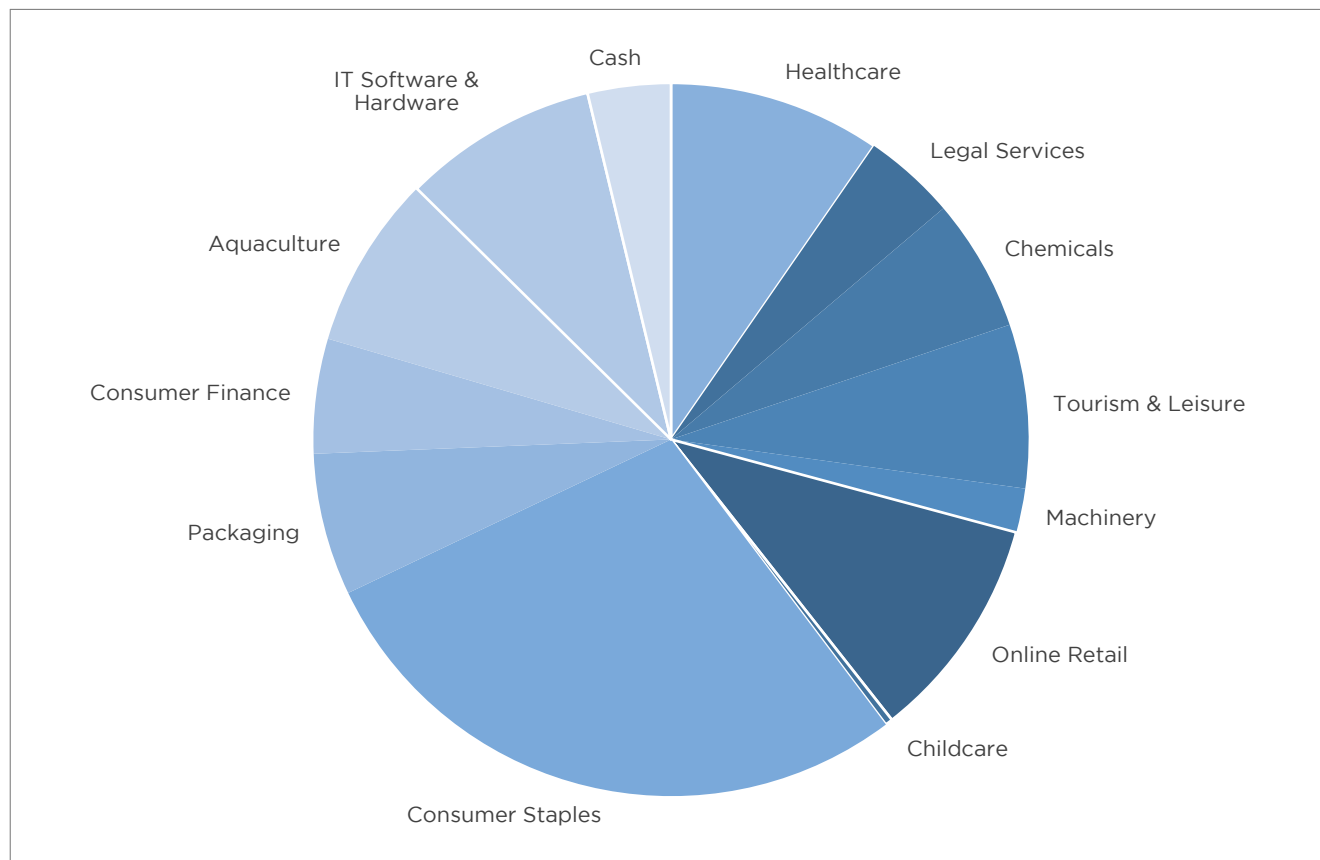
Pro-Pac Packaging Limited (PPG, +11%) delivered another pleasing result with continued margin expansion as it streamlines its revenue base (exiting businesses and products that generate minimal profit), consolidates some of its assets and upgrades its management systems. While PPG is still guiding to Profit Before Tax (PBT) to be higher than the pcp, the statement doesn't quite capture what we think is the potential for strong growth this year, and particularly next, as it reaps the benefits of the work it is currently undertaking. Based on our estimates, at its current share price of \$0.19 we estimate that PPG is trading on a P/E of <7.5x, which in our view is compelling, especially when its largest shareholder (owning 51.6%) has continued to buy stock at prices well above current levels.

Shine Justice (SHJ, -2%) reported its 1H FY21 result, continuing its trend of delivering improving margins and cash flow conversion as it increases its revenue mix towards new practice areas (such as Class Actions, which attract higher margins), maximises its external disbursement funding and maintains strict control over its costs. SHJ is still guiding to high single digit percentage earnings growth in FY21, helping to underpin a FY21 dividend yield of >5% that should continue to steadily increase in the years to come. However, we think the key catalysts for the stock remain the completion/settlement of the Mesh Class Action proceedings (note that the appeal by Johnson & Johnson has just been dismissed), demonstrating further success in other active Class Actions, and executing on opportunities for accretive M&A deals to build further scale in its preferred practice areas.

Unsurprisingly, Catapult (CAT, +2%) had a challenging 1H FY21 result given the effects of COVID-19 on professional sporting competitions across the globe. Despite the interruptions and uncertainty for their customer base, CAT still managed to achieve 8% growth in its Annual Contract Value (ACV), reduced ACV churn to 4.5%, expand its Contribution Margin from 46% to 50% and generate positive free cash flow. Nonetheless, the difficult operating environment for driving new sales led to a minor decline in total revenue, which was also partly impacted by the ongoing deliberate pivot from a capital sales model to subscription based (which attracts higher margins). While the next six to 12 months will likely remain somewhat challenging, this was always going to be a period of transition for the business and we are very encouraged by its ability to navigate through the past year without any major impact to its core business (in fact it has improved). On that basis, we are happy to adopt a long-term view and back what we consider to be a high quality management team to leverage their dominant suite of products and exceptional customer base to drive sustained high sales growth and margin expansion.

## Portfolio characteristics

We currently have ~96% of our capital invested in 17 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 April on our performance during March.

Kind regards,

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