Emerging Companies Fund

Monthly Update: April 2021

Dear Fellow Investors,

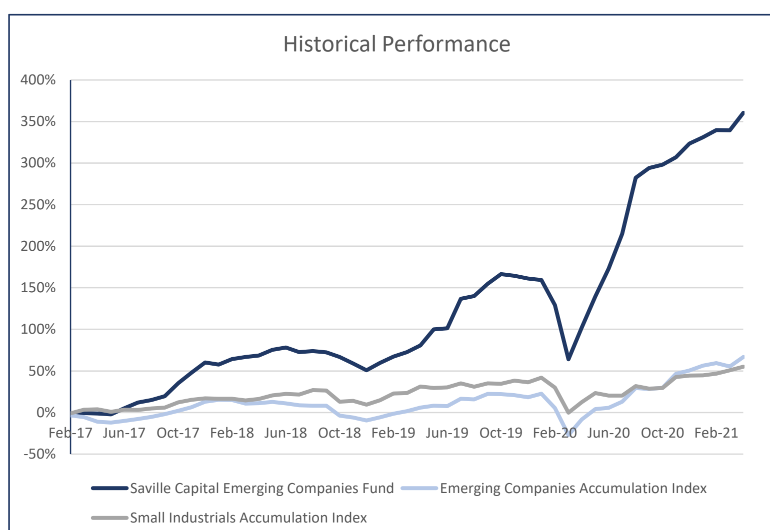
Our Emerging Companies Fund was up +5.0% in April vs +7.5% for the Emerging Companies Accumulation Index (XECAI) and +3.9% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund is +360.3% (assuming distributions are reinvested) vs +66.9% for the XECAI, +55.1% for the XSIAI and +17.1% for our cash-based benchmark. The Fund has generated a return of +43.3% p.a. since inception.

April was a strong month for the Fund and the broader market, albeit cyclicals and commodity stocks were again the main drivers behind the buoyant market conditions. Given we have limited exposure to cyclicals and no exposure to commodities, the key driver of our comparable performance was largely stock specific, being a positive market response to strong quarterly results from a few of our key stocks. Nonetheless, despite continuing to generate very pleasing returns, in the short term we think our Fund will face an ongoing broader sentiment headwind, specifically the desire of the market to sell structural winners (particularly any stocks that performed very well during the widespread lockdowns induced by COVID-19) and buy cyclical stocks that have significantly underperformed during that period (albeit are now rapidly recovering). While our fundamental bias will always be towards structural over cyclical growth stories, we are surprised at how much the market is willing to pay to gain exposure to an improving (and more open) global economy. Firstly, the global battle against COVID-19 and its expanding variants is unfortunately not yet over, secondly, the economic recovery will not be synchronised (COVID-19 is wreaking havoc in several developing countries) and finally, it is being partly built on unsustainable fiscal and monetary policy. Therefore, our concern is the cyclical upswing might ultimately disappoint, in both its strength and longevity.

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%	+1.0%	+2.3%	+4.0%	+62.3%		
2021	+1.9%	+2.1%	-0.1%	+5.0%									+9.1%	+7.1%	+128.4%

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



Performance commentary

The key positive contributors comprised Murray Cod (MCA, +55%), Lark (LRK, +21%) and a fairly recent addition, Universal Biosensors (UBI, +41%). The key negative contributors were IDT Australia (IDT, -20%), Redbubble (RBL, -18%) and Imricor (IMR, -6%).

MCA generated growth in cash sales of +205% on pcp, also up almost +50% on the previous quarter, a fantastic result. But more importantly, MCA announced that it will be launching a premium branded product into selected Woolworths stores, commencing in May 2021. This provides the opportunity to access the distribution power of Australia's largest retailer, potentially underpinning a significant portion of MCA's future volumes, while also providing valuable brand recognition and access to a much broader cross-section of consumers. It will be for an initial 12-week period and will commence in NSW via targeted stores. MCA also announced that it has executed a supplier agreement with PFD Foods. PFD has over 70 branches across metropolitan and regional Australia, thus substantially broadening MCA's distribution footprint, particularly in regional areas which have been difficult to access. MCA has also signed a supply agreement with Bidfood Australia, which supplies over 38,000 foodservice operators each month with food, meat and liquor. Finally, stage one of construction at the impressive new Whitton site (which we recently visited in-person) has been completed and fish have been stocked into the site, with construction of stage two now underway and expected to be completed in Spring.

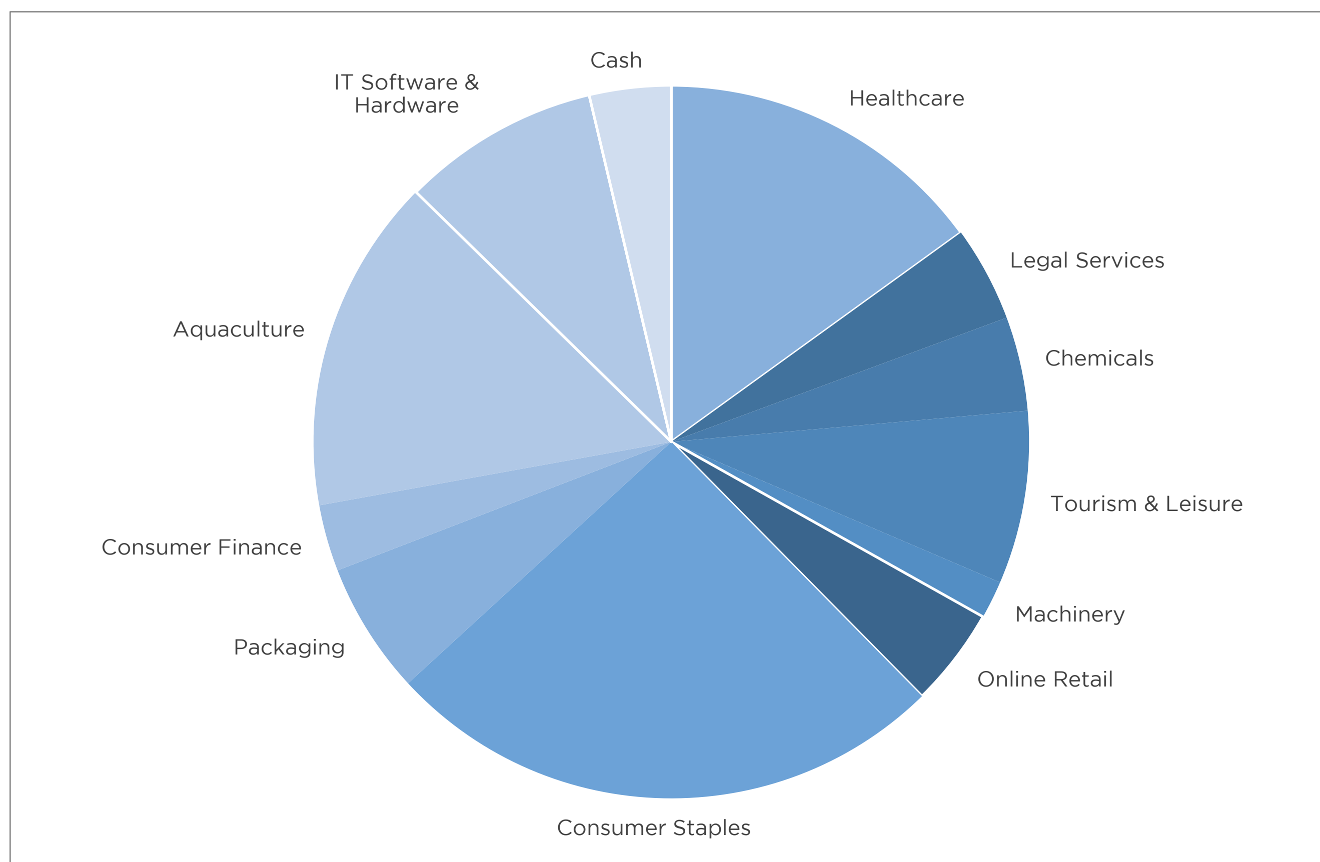
Marley Spoon (MMM, +6%) reported a stellar 1Q result, with revenue at €77.4m, +81% on pcp, +12% on 4Q CY20 and +6% above the peak revenue period of 2Q CY20, leading to upgraded CY21 revenue guidance of 30-35% (previously 25-30%). Its 1Q contribution margin was a little soft at 28% (below its reiterated guidance of 30-31% for CY21) due to a combination of weather-related challenges (Australia floods, winter storms across the US/EU) and infrastructure-related issues driven by the ongoing e-commerce boom. But as implied by the guidance, margins are expected to improve as we move further into CY21. Given the muted market response to what we considered to be a strong update, and the fact MMM is now trading on just 1.2x CY21 EV/Sales, it is clear that many potential investors remain sceptical about the sustainability of MMM's increased revenue and subscriber base, despite mounting evidence to the contrary. As we alluded to earlier, this is part of a broader trade thematic which is seeing the market sell beneficiaries of the accelerated structural shift to online in favour of buying stocks that were hit hard by the lockdowns imposed during 2020. We believe this strategy is as simplistic as it is flawed, but for now the trend is gathering momentum and may continue for some time yet.

LRK also reported an outstanding result for the March quarter, with net sales growth of +159% and gross profit growth of +210%, driven by a significant improvement in gross margins from 60.5% to 72.4%. The uplift was underpinned by the continued growth and success of its Limited Release program, while further development of national key accounts also added to sales volumes. Pleasingly, this growth is off an operating cost base that remains very controlled relative to the level of revenue growth it is supporting.

RBL reported solid revenue growth for 3Q FY21 (+54% on pcp, +76% constant currency), however it again disappointed on its GPAPA margins (24.7% vs 25.9% in pcp and 34% at its peak in 1Q FY21) due to a combination of product mix and much higher paid marketing. Furthermore, RBL gave guidance for near term EBITDA margins in the mid-single digits, increasing to 10-15% by CY24 onwards, both of which were well below our, and market, expectations. Conversely, its aspirational revenue target of $1.25b in CY24 was well above our, and market, forecasts, but management's level of confidence in this figure appeared low. In conclusion, it was another underwhelming update from the Company in advance of a period where revenue growth is likely to be challenged (probably goes negative) and operating leverage will be working against it. Longer term, we still think the business is very well positioned and too cheap for what it offers, but over the last few months we trimmed our position considerably with the view that we will likely have an opportunity to add to it again at lower prices, particularly if the data continues to disappoint the market.

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 June on our performance during May.

Kind regards,

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