Emerging Companies Fund

Monthly Update: September 2021

SAVILLE CAPITAL

Dear Fellow Investors,

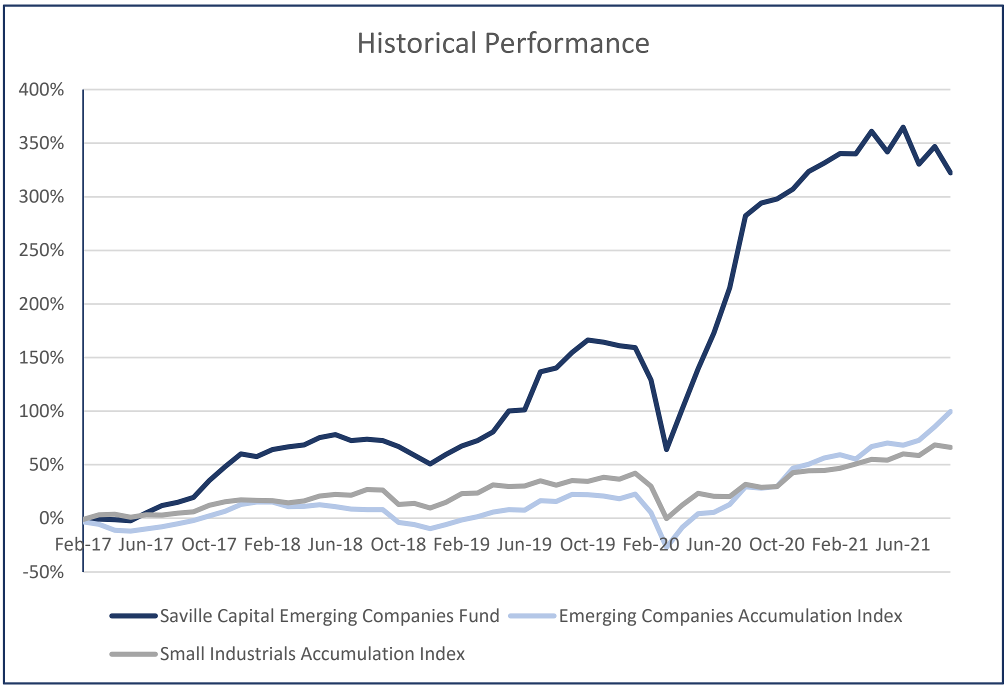
Our Emerging Companies Fund was down -5.5% in September vs +7.7% for the Emerging Companies Accumulation Index (XECAI) and -1.3% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +36.2% p.a. and a total return of +322.5% vs +99.7% for the XECAI and +66.2% for the XSIAI.

In an unfortunate continuation of recent trends, September was another difficult, and turbulent, month for the Fund and broader markets. Yet again the strong upwards move in the XECAI was an outlier, with all other major indices down for the month (including the S&P ASX200, which was -1.9%). In terms of delving into our own poor performance, it was again largely caused by one stock, Marley Spoon (MMM, -30%). For context, had we not owned MMM during September, then the Fund would have been down -1.3% for the month, which is more in line with most of the indices. However, we must accept that the effects of holding concentrated positions cuts both ways, it amplifies our successes and indeed our failures (even if we consider this “failure” to be temporary). The silver lining is that we would much rather suffer poor Fund performance due to just one position, as opposed to many, as it is far easier to rebound sharply at some point in the future under those circumstances, especially in the case of MMM which in our view hasn’t experienced any permanent impairment to its business or medium to long term earnings potential.

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%	-4.4%	+5.5%	-8.0%	+4.3%	-5.5%				-0.2%	-9.4%	+7.2%

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



Performance commentary

The largest positive contributors were Tourism Holdings (THL.NZ, +7%), Shine Justice (SHJ, +5%) and Lark Distilling (LRK, +2%). The largest negative contributors were Marley Spoon (MMM, -30%), Universal Biosensors (UBI, -11%) and Pro-Pack Packaging (PPG, -9%).

MMM's significant de-rating in September was driven by the negative perception and demand/supply imbalance created by the decision of W23 Investments (an affiliate of Woolworths) to sell its ~10% stake. W23 acquired ~28m shares in MMM in late August upon conversion of two convertible bonds it had held since 2019, which it then immediately sold, realising significant gains on the investment. The 5-year strategic alliance between MMM and Woolworths remains intact, however the perception of the Woolworths sale, as well as the significant demand it soaked up in the market, sent the share price into a further negative spiral. MMM has now declined over 50% since the end of June, which is extraordinary given the Company continues to deliver solid growth despite cycling a very elevated pcp, and should restore its margins to >30% in 4Q CY21 following recent price rises in the US. Based on our CY21 forecasts, which are below consensus, MMM is now trading on 0.8x EV/Sales and 1.8x EV/GP, which is not only well below its own average in recent times, but in staggering contrast to its key comparable, (HelloFresh, EV/Sales of 2.4x) and other listed businesses with subscription revenue models. Finally, it puts it in line with the implied CY21 EV/Sales multiple HelloFresh is paying for Youfoodz (YFZ), which produces and distributes ready-made meals to supermarkets in Australia only.

Meanwhile, IDT Australia (IDT, -6%) received its Sterile Manufacturing Licence from the TGA, another key step in its pursuit of a Government-backed deal to manufacture a COVID vaccine. Finally, Imricor (IMR, +0.0%) raised $16.5m via a placement (in which we participated) at $1.00/share to support its product development, clinical and regulatory costs as well as fund its sales and marketing initiatives. IMR has been severely impacted by COVID but its technology remains compelling and we expect this to be reinforced with the resumption of regular operations and more hospital sites are signed as we enter CY22.

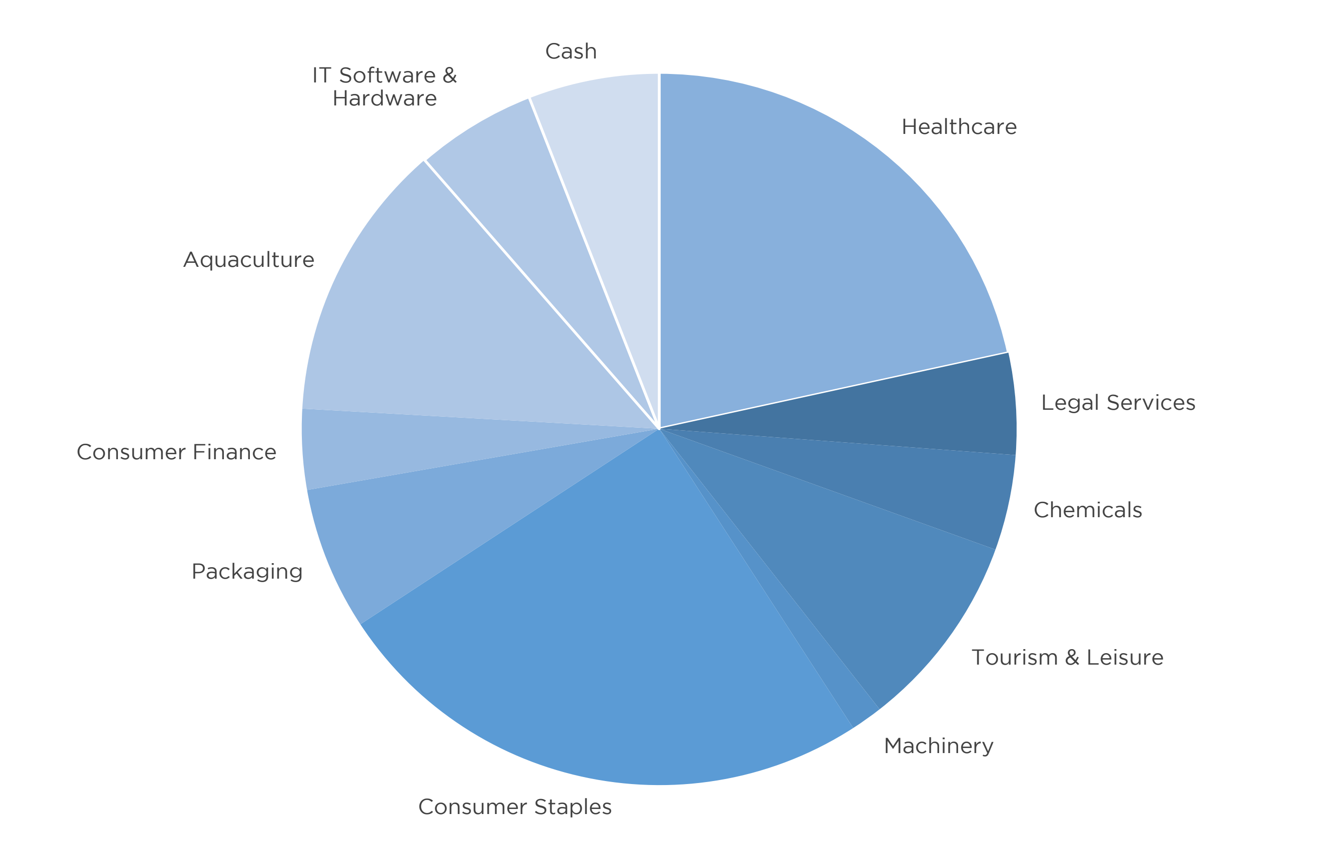
Company in focus: Mighty Craft Limited (MCL)

MCL owns and operates various breweries, distilleries and bars in Australia, with its key brands including Jetty Road (beer), Mismatch (beer), 78 Degrees (gin), Slipstream (beer), Kangaroo Island (spirits), Seven Seasons (spirits) and Hidden Lake (whisky). MCL's business model is to acquire unique craft brands with genuine local providence that can be distributed via MCL's national network of retailers, including Dan Murphy's and BWS. While there are many successful craft beer and spirits brands throughout Australia, they all face difficulty in achieving scale via national distribution, primarily because it is inefficient for large retailers to deal with individual brewers/distillers. By creating a portfolio of these brands, MCL overcomes these challenges as well as participating in the significant potential upside via their direct equity ownership. The Australian craft beer/spirits market is growing strongly but remains highly fragmented, creating a significant pipeline of acquisition opportunities for MCL to build its portfolio and increase its own size and liquidity, gradually making it more appealing for institutional investors.

We first acquired a stake in MCL at $0.32/share via a $29m capital raising it conducted in June to help fund the $47m acquisition of Adelaide Hills Group. This transformational deal increased MCL's FY22 guidance from $50m to $78.7m in revenue and from -$2.5m to +$6m in EBITDA, while also significantly increasing MCL's market capitalisation and liquidity. Unfortunately, subsequent lengthy lockdowns across Victoria and NSW have led to the withdrawal of FY22 guidance given that 50% of its forecast revenue is from owned venues and wholesale on-premise trade, the majority of which comes from those States. While disappointing in the short term, the investment thesis behind MCL remains intact and we look forward to strong revenue growth in 2H FY22 as venues fully re-open and enjoy a strong summer of trading. More importantly, we continue to see first-hand evidence of MCL's superior distribution capabilities on display, having noticed several of its key brands popping up in bars/liquor stores that are in different States to their origin.

Portfolio characteristics

We currently have ~94% of our capital invested in 15 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 November on our performance during October.

Kind regards,

Jonathan Collett

Principal

Saville Capital

+61 3 9769 1789
jcollett@savillecapital.com