Emerging Companies Fund

Monthly Update: December 2021

SAVILLE CAPITAL

Dear Fellow Investors,

Our Emerging Companies Fund was down –9.6% in December vs +4.3% for the Emerging Companies Accumulation Index (XECAI) and +0.8% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +30.4% p.a. and a total return of +268.4% vs +116.2% for the XECAI and +64.2% for the XSIAI.

We have always deliberately tried to create a concentrated portfolio that isn't correlated with any particular index, which helps to optimise our performance when things go according to plan, but can appear inexplicably poor when things do not. While the market environment for small cap growth stocks remains challenging (unless you have lithium exposure), those headwinds were exacerbated for our Fund this month largely due to the performance of one stock, IDT Australia (IDT, -58%). Without question, the past six months for the Fund have been particularly disappointing and while we think we have suffered from some unfortunate timing of events, there are certainly lessons we have learned, particularly with regards to even more active management of positions in the Fund that have already performed well.

However, the fact that we have declared a distribution of $0.05/unit for the six-month period ending 31 December 2021 demonstrates that on a realised basis, we still generated positive returns in the Fund. Furthermore, we certainly don't expect our current unrealised losses to become permanent and would encourage investors to look forward with optimism, as the businesses we own are carefully selected and our investment process has generated strong results over time for those willing to accept the volatility of operating a concentrated Fund in this segment of the market. Furthermore, December is often a very poor month for determining the fair value of a portfolio as liquidity dries up and significant share price moves can occur with little or no logic. For example, Imricor (IMR) declined 15% on just 1.2% of its total shares on issue being traded during the month and Murray Cod (MCA) declined 9% on 0.5% being traded. Conversely, Marley Spoon (MMM) was up 15% on 9% of its shares on issue traded, a move which (in theory) has more conviction.

As everyone should be aware, we are now trading well below our high watermark and no performance fees will be payable on those units until we recover to parity and grow again from there. As always, we will be working very hard to ensure we achieve that through the disciplined application of our investment process. We have been through periods like this before (and unfortunately will inevitably do so again) but staying true to our approach is the best way forward to generate the level of gains we have achieved to date.

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%	+1.0%	-4.5%	-9.6%	-13.0%	-12.8%	-13.0%

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

Performance commentary

The key positive contributors were Marley Spoon (MMM, +15%), Universal Biosensors (UBI, +12%) and Tourism Holdings (THL.NZ, +5%). The key negative contributors were IDT Australia (IDT, -58%), Pro-Pack Packaging (PPG, -24%) and Murray Cod (MCA, -9%).

As our long-term investors will know, we have owned IDT for over three years now, having first invested when it was $0.13 (it closed the month at $0.255). While COVID-19 has created some significant opportunities for the business, several of which remain live, it has also introduced a highly speculative investor base that has led to extreme share price volatility as they attempt to predict Government announcements regarding vaccine manufacturing contracts that may involve IDT. Ordinarily, we try to manage this through adjusting our portfolio weighting by trimming into share price strength, but because it surged on the last day of November, it entered December at its highest weighting since we first invested in the stock. Then in mid-December the Federal Government announced that IDT would not be part of its collaboration with Moderna to produce mRNA vaccines in Australia. Clearly this was a disappointing outcome for many stakeholders, especially given it will be a greenfield project that will take years to complete with no interim solution to our reliance on imported mRNA vaccines. However, IDT's submission to the Federal Government's $800 Modern Manufacturing Initiative (MMI) Grant remains live as does the work it is doing with the Monash Institute on its COVID-19 vaccine development. Furthermore, owning a TGA/FDA approved sterile manufacturing facility with a replacement cost of ~$80m (vs current market cap of ~$60m) in the designated hub for mRNA drug development in Australia remains a strategically valuable asset. As such, while we are very frustrated by the share price volatility and the effect it is having on our Fund's short-term performance, we do not consider it to be rational to follow or try to pre-empt the trading habits of those choosing to engage in pure speculation, with minimal reference to the potential long-term value of the Company despite the dynamic environment.

MMM announced the acquisition of Australian ready-to-heat meal company, Chefgood, for A$21m, with additional earn-outs of up to ~A$5.6m over the next 2.5 years based on achievement of revenue targets (funded by either cash or scrip). Chefgood offers more than 30 meals rotating every week across different subscription plans targeting healthy and weight-conscious consumers, while also offering a small range of add-on items. The Company is operating at a $26m revenue run-rate (up 137% on pcp) and is generating positive EBITDA and net cash flow. This acquisition gives MMM a foothold in a growing and complementary category and will allow it to leverage its operational, digital and customer assets, providing both revenue and cost synergies for both companies. The transaction is expected to be funded by an $8m equity placement with a European institutional investor at $1.00 (a 43% premium to its $0.70 share price at the time of announcement, now $0.94) and an $11m extension to MMM's existing debt facility with Runway Growth Capital. We think this acquisition has significant strategic and financial merit for MMM as it expands its addressable market, enables cross-selling opportunities across both customer bases and deepens its expertise in a market (ready-to-heat meals) it is seeking to also enter in its other existing geographies. Furthermore, the issuance of equity at a significant premium is not only a strong vote of confidence in MMM's operating outlook, but also demonstrates to the market that its current cash flow profile, capital structure and poor share price performance is not impeding its growth ambitions.

Imricor (IMR, -15%) announced that the German Heart Centre and the Charité Medical University, both in Berlin (Germany), are the latest two institutions to adopt IMR's ablation solutions with a contract term of three years. Planning is now underway for procedures to commence at these sites in the first half of 2022. These new customers bring the total number of IMR sites to 13, however despite recent progress the downward pressure on IMR's share price has continued. We can only conclude that some investors remain fixated on the short-term potential for COVID-19 hospitalisations in Europe to impede IMR's ability to sign on more new sites and impact those sites wanting to undertake elective procedures using IMR's cardiac ablation products in early 2022. While COVID-19 is still posing challenges, it feels like we are a lot closer to the end than the beginning, regardless in our view it doesn't change the significant long term potential value of the Company.

THL announced that it has entered into a conditional Scheme Implementation Deed to merge with Apollo Tourism & Leisure (ATL). The merger will result in THL shareholders owning ~75% of the merged entity, under which both brands will continue to operate. However, given the cross over in their operations, there are significant cost out synergies available which are expected to deliver a steady-state EBIT benefit of $17m to $19m pa, as well as fleet rationalisation benefits expected to reduce net debt by over $40m. THL will also apply to be dual listed on the ASX through a foreign-exempt listing, which should substantially improve liquidity and institutional interest. We think the deal has significant strategic merit given it creates a global commercial RV rental leader in Canada and the US, Europe and the UK as well as its Australasian operations, supported by strong manufacturing capability and retail vehicle sales. It will also create a more diverse and resilient business, helping it to navigate what we hope will be the final stages of the pandemic and then a strong recovery phase. The deal is subject to regulatory approvals in both Australia and New Zealand, however the Company is not anticipating any issues given the breadth of transport and tourism offerings within those markets.

UBI had another busy month in which it signed a Master Collaboration Agreement with the Mayo Clinic, one of the world's most prestigious oncology research and treatment institutions based in the USA. The Agreement covers multiple potential projects including work on UBI's Tn antigen cancer biosensor. UBI also entered into a global exclusive Licence Agreement with IQ Science Limited for commercialisation of a COVID-19 test that will use UBI's proprietary electrochemical strip and device technology designed to provide a result to a patient's viral status within 30 seconds from a small saliva sample. UBI's test also has the potential to measure the relative viral load associated with a patient's infection status. If commercialised, the potential applications for this test would be substantial given that current rapid antigen tests for COVID-19 have limited sensitivity and take 15 to 20 minutes to deliver results, meanwhile PCR tests can take days and are very expensive. While still early days, both agreements continue UBI's progress towards substantially growing the potential addressable market for its technology platform.

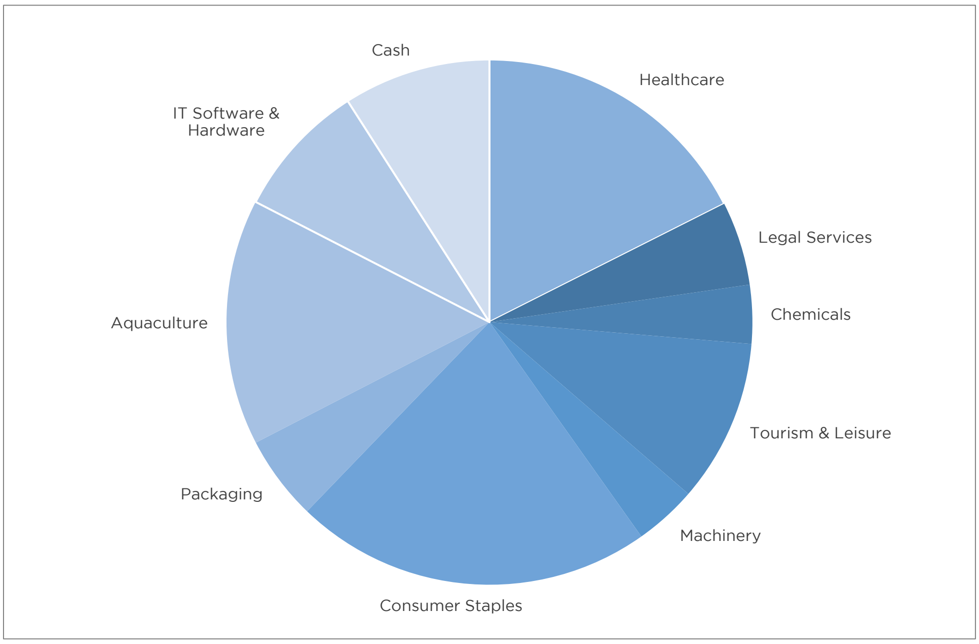
We added The Hydration Pharmaceuticals Company (HPC, +3%) to the Fund via an IPO on 14 December. HPC sells a range of liquid, tablet, and powder hydration products under its Hydralyte brand through retail, e-commerce (primarily Amazon), and direct channels. Based in San Diego, USA, HPC has exclusive rights to sell Hydralyte across North America (its current focus), Europe, China and South America. The Australasian, SE Asia, Middle East and Africa territories have been previously sold to Hydralyte Australia (owned by Care Pharmaceuticals). The Company raised A$17m via an IPO at an offer price of $0.29/share. The proceeds will be used primarily to fund sales, marketing and brand and product development costs. HPC generated ~77% sales growth in the 12 months to September 2021, with gross margins in excess of 40%, but is not yet EBITDA positive. However, given the scalability of its business model, we anticipate that the funds raised at IPO will see it through to profitability. Regardless, the track record of HPC's management team, the performance of its products and brand in Australia (and now Canada, to date) gives us confidence that this will prove to be a solid long-term investment for the Fund.

PPG provided its second trading update in a month, noting that the effects of COVID-19 on global supply chains and labour costs/availability have limited the business's ability to convert work in progress, especially as it received an influx of orders prior to its December price increases. As a consequence, PPG expects 1H22 to be further impacted by ~$3m, resulting in an underlying PBT of ~$4m (vs $11.7m in pcp). Management did comment that the influx of orders (once fulfilled) and other actions already taken will have a material positive impact on its 2H22 result. Unfortunately, the issues being faced by PPG are far from unique to them, which only serves to highlight how volatile the upcoming reporting season will be for labour intensive/cyclical stocks. But with PPG trading on a normalised EV/EBITDA of 3.5x and P/E of ~10x, with further cost out benefits to be realised, there is little sense in taking action to exit the stock based on these short-term headwinds.

Finally, we exited our position LBY due to a confluence of events that comprised a weak quarterly result (the first one that has been materially below our expectations) and a share price in persistent decline (with no regard for relative or absolute valuation metrics) that has now become self-fulfilling, as its market cap is approaching its annualised cash burn rate. That is a completely unsustainable position for a Company that will soon require more equity capital, thus putting the Company's survival at risk unless it can find a large strategic investor to underwrite its capital position (and future). With that backdrop, we were left with no choice but to cut our losses and move on from what has been a disastrously poor (share price) performer since its successful listing in September 2020.

Portfolio characteristics

We currently have ~91% 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 February on our performance during January.

Kind regards,

Jonathan Collett

Principal

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