Emerging Companies Fund

Monthly Update: April 2022

SAVILLE CAPITAL

Dear Fellow Investors,

Our Emerging Companies Fund was down –5.8% in April vs –4.3% for the Emerging Companies Accumulation Index (XECAI) and –2.1% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +21.7% p.a. and a total return of +180.2% vs +107.4% for the XECAI and +46.1% for the XSIAI.

Despite having a month where several of our key stocks delivered very encouraging quarterly updates/news flow (most notably MCA, AND, PPG, TGH, MMM and HPC), unfortunately the macro headwinds plaguing the market (and our segment in particular) continued to overwhelm stock specific news flow. History, and logic, tells us that improving company fundamentals will eventually be recognised and rewarded by markets, but in the current environment investors are inclined to largely ignore good news (unless it is exceptional) and punish stocks that report any bad news. Conversely, we have been through periods where the complete opposite occurs, which grants us an opportunity to take profits, but ultimately neither are rational nor sustainable environments. As we have previously stated, until we see some evidence that inflation might have at least peaked and/or the trajectory of bond yields starts to flatten, the market environment is likely to remain difficult for our investment strategy. The silver lining might be that the market is now pricing in a combination of significant central bank rate hikes as well as poor earnings growth for many stocks over the next 12 months and beyond, so the stage is at least set for potential positive surprise (particularly at the individual stock level).

Furthermore, for those that are not actively or closely monitoring individual stock/sector moves, it is important to highlight that the headline indices are not representative of the significant de-rating we have already observed across multiple segments of the market. To that end, we recently saw an interesting statistic that we thought captured the situation quite well. As at the start of May, more than 45% of stocks listed on the Nasdaq are down 50% from their most recent peak, more than 22% are down 75% and more than 5% are down 90%. Conversely, at that date the Nasdaq was down ~24% from its peak, which is still a significant decline but certainly doesn't reflect what a significant proportion of stocks within the index have experienced. Albeit interestingly, it appears that in recent days the mega-cap tech stocks have started to play catch-up with their smaller peers.

More importantly, as mentioned above, we are seeing encouraging signs from numerous companies within our portfolio regarding their earnings growth prospects. While we completely understand that the patience and resolve of our investors is being tested during this period, as is ours, we remain confident that it will be rewarded. Time and time again we have seen that unless there is a fundamental change, selling out of investments during periods of extreme volatility/weakness ultimately becomes a source of regret.

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%		
2022	-7.9%	-9.6%	-3.0%	-5.8%									-23.9%	-17.4%	-40.7%

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

Performance commentary

The key positive contributors were Terragen (TGH, +61%), Pro-Pac Packaging (PPG, +26%), Tourism Holdings (THL.NZ, +5%). The key negative contributors were Imricor (IMR, -25%), Murray Cod (MCA, -13%) and Redbubble (RBL, -26%).

MCA bounced back with a much stronger March quarter, with cash sales up +48% on pcp and a modest operating cash surplus, despite the impact of Omicron-induced closures during January and February. Furthermore, MCA stated that price rises of 10% have been announced to customers of chilled fish (outside of any fixed price agreements which are subject to review at set dates) and will begin on 1 May 2022. Importantly, biological growth also improved during the March quarter with fish stocks growing at faster than anticipated rates. This is in contrast to the slower growth that was reported due to cooler conditions in the prior quarter. The Company once again reiterated that there is no change to its target of producing 10,000 tonnes by 2030. In terms of distribution, MCA confirmed that Coles will stock Aquna Cod in 80 stores from 25 May 2022 and export sales are slowly ramping up again, particularly in the US and Japan. From our perspective, the Company continues to progress towards creating a business of substantial size that will generate significant value for long term shareholders, such as ourselves.

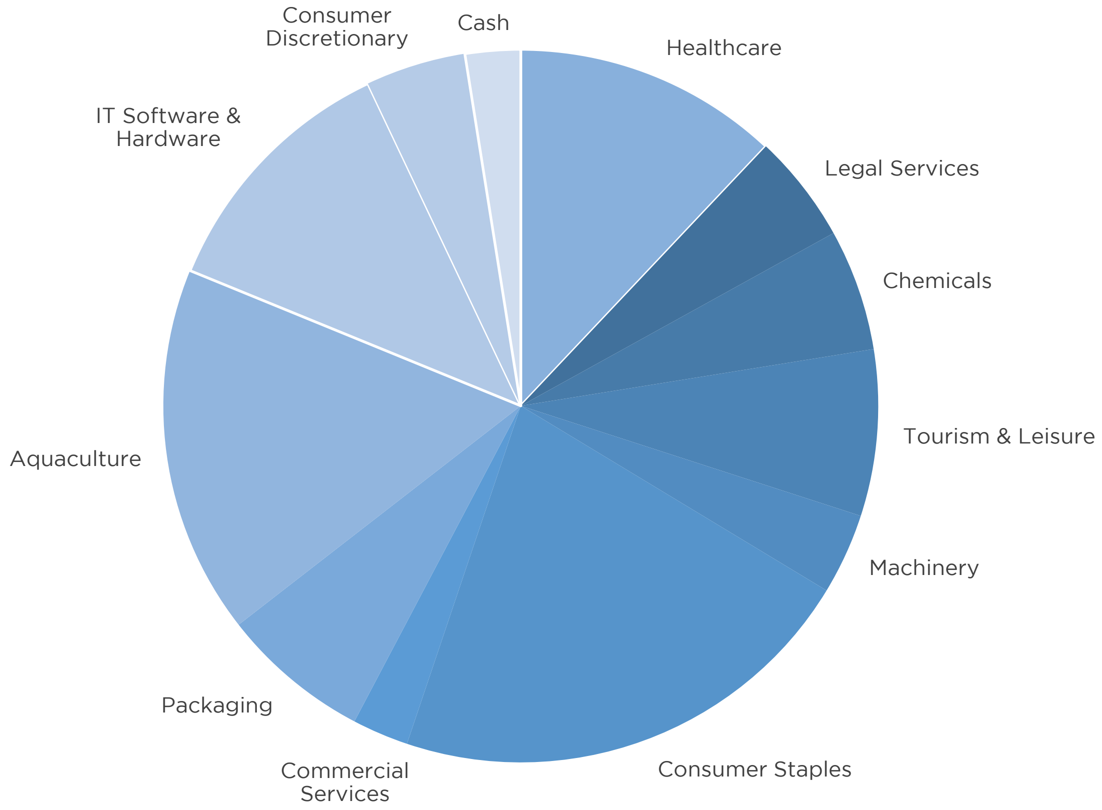
Marley Spoon (MMM, -8%) surprised the market (and us) with a very strong revenue result for 1Q CY22, coming in at €103m, up 32% on pcp and up 23% on 4Q CY22 (which was a previous record result). Unsurprisingly, contribution margins remain under pressure, however MMM is again combatting input cost inflation with price rises of ~6% in 2Q. Given that the average Marley Spoon customer earns US$250,000 pa, the Company remains confident that these price rises will be absorbed with minimal customer churn. We still think the Australian market misunderstands the meal kit proposition and underestimates the stickiness of longer-term customers that value the convenience, variety and healthy routine that a meal kit service offers. Furthermore, with the addition of “Market”, which offers premium grocery items and ready-to-heat meals (via Chefgood), MMM is expanding its value proposition to customers, while leveraging its existing cost base and footprint. MMM reiterated its guidance for mid to high teens revenue growth (appears conservative), margins in line with CY21 and an EBITDA loss of <€15m, which implies that the Company will likely be EBITDA neutral to positive in 2H CY22, which is often a catalyst for a significant re-rating. While it was a different market environment, it is noteworthy that the last time MMM shifted to positive EBITDA (2Q CY20), the stock surged to $3.00/share.

PPG announced the sale of its Rigid packaging business to TricoBraun Inc for $56m, with completion expected by 30 June 2022. While the divestment of the Rigid division (which has been in decline) didn’t come as a huge surprise given management commentary in the past, the price realised certainly did. We understand that the price paid implies 8.7x EV/EBITDA, and yet we estimate that PPG, as a whole, is trading on <5x EV/EBITDA. In addition, PPG reiterated that it is still on track to meet its earnings guidance for FY22, which implies a very strong 2H off the back of significant price rises in December 2021 and ongoing volume growth as more customers seek to bring their suppliers onshore.

TGH announced the results of research it has been conducting at Ellinbank SmartFarm, which showed that with a baseline dose of 10ml of Mylo® the methane emissions from cows were 7.5% lower and their weight gain was 21% higher than the control group. This research indicates that Mylo® can reduce methane emissions by the equivalent of 100 tonnes of CO_2 per 350-cow dairy farm per year. More research at Ellinbank SmartFarm is planned to determine if higher doses of Mylo® will reduce methane emissions further, however in the interim this should at least open the door for TGH to initiate discussions with large dairy groups about collaborating on an environmentally friendly milk, that has the added benefit of potentially generating income for farmers via carbon credits (let alone the benefits that come with the additional weight gain). The 3Q FY22 sales result from TGH was an improvement on 2Q (up 20%) but was still slightly below the pcp as the Company transitioned to a new sales team. However, TGH provided a graph of monthly sales, showing a clear uptick during March, which bodes well for subsequent quarters.

Portfolio characteristics

We currently have ~97% 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,

Jonathan Collett

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Important Information