

Emerging Companies Fund

Monthly Update: June 2022



Dear Fellow Investors,

Our Emerging Companies Fund was down -15.5% in June vs -18.6% for the Emerging Companies Accumulation Index (XECAI) and -10.0% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +13.1% p.a. and a total return of +95.1% vs +55.8% for the XECAI and +21.8% for the XSIAI.

June was a very poor month for most asset classes across the globe and naturally our Fund was again impacted. But rather than focus on the negatives, of which there have been many in recent times, we thought it would be better to highlight some positives. Firstly, with about a week to go, the Fund was down ~24% for the month, so we did observe a decent rally (>10%) to achieve the final result of -15.5%. Pleasingly, this positive momentum has continued into July, thus far. Secondly, despite a very poor year of performance for FY22, the vast majority of our clients have kept their investment in the Fund, which has enabled us to execute on our strategy of making, and persisting with, long term investments, therefore continuing to act in the best interests of all unitholders.

This commitment to staying the course and ignoring share price noise is evidenced by the fact that we have declared a distribution of ~\$0.06 for the six months ended 30 June, despite reporting significant unrealised losses. Not only does this provide clear evidence of executing our stated investment approach (i.e. we don't sell because share prices move against us nor trade stocks to try to paper over cracks), it also positions us best for when the market inevitably swings back in our favour. To that end, we are cautiously optimistic that the recent retreat in 10-year bond yields (if sustained) and the end of an unusually aggressive tax-loss selling period bodes well for our Fund's performance over the next six months. More importantly, our ongoing dialogue with each of our companies remains broadly positive with regard to their funding and operating outlook, which should be recognised in their share prices as/when market conditions stabilise/improve.

The best example of how sharply momentum can turn is Imricor (IMR, -12.5%), which has declined from a peak of ~\$2.80 in late 2020 to an astonishing low of \$0.11 on 20 June 2022. Since then, the share price has climbed ~170% to its current level of \$0.30. While this is still almost 90% down from its peak, and remains well under our average entry price of \$1.44 (and our own DCF valuation), we were able to buy 1m shares (equating to 0.7% of the Company) at its lows, which cleared out a forced seller. Clearly IMR remains a very disappointing investment for the Fund to date, but fundamentally nothing has changed, it has merely experienced delays in its rollout (primarily due to COVID). Just as we observed with IMR during June, we again saw multiple directors buying across the portfolio (including MMM, BCT, HPC, MCL) which is always an encouraging sign that despite the share price declines, insiders are still confident in the operational direction of the business.

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%	-17.6%	-15.5%							-47.0%	-34.4%	-58.1%

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

Performance commentary

The only positive contributor during June was Terragen (TGH, +3.4%). The key negative contributors were The Hydration Pharmaceuticals Company (HPC, -48%), Pro-Pac Packaging (PPG, -46%) and Marley Spoon (MMM, -41%).

IMR provided a positive update in which it announced an agreement with Siemens to enable deployment of its 3D mapping system across all newer Siemens MRI scanners. This will also facilitate the participation of Siemens iCMR sites in the planned VT clinical trial. Furthermore, it noted that atrial flutter procedures using IMR's products continue to commence across the Company's contracted sites. Most recently, the Haga Teaching Hospital in The Hague started performing procedures again in June. Cases are also expected to re-commence at the Amsterdam University Medical Center, meanwhile installations are now complete at Policlinico Casilino in Rome and Henry Dunant Hospital Center in Athens with cases expected to commence at those sites in the coming months.

MMM announced that it achieved the required milestones to access Tranche 2 of its senior secured credit facility with Runway Growth Capital, enabling it to draw down an additional US\$20m of debt funding. These proceeds will be used for general working capital purposes as the business transitions to being self-funding over the next six to 12 months.

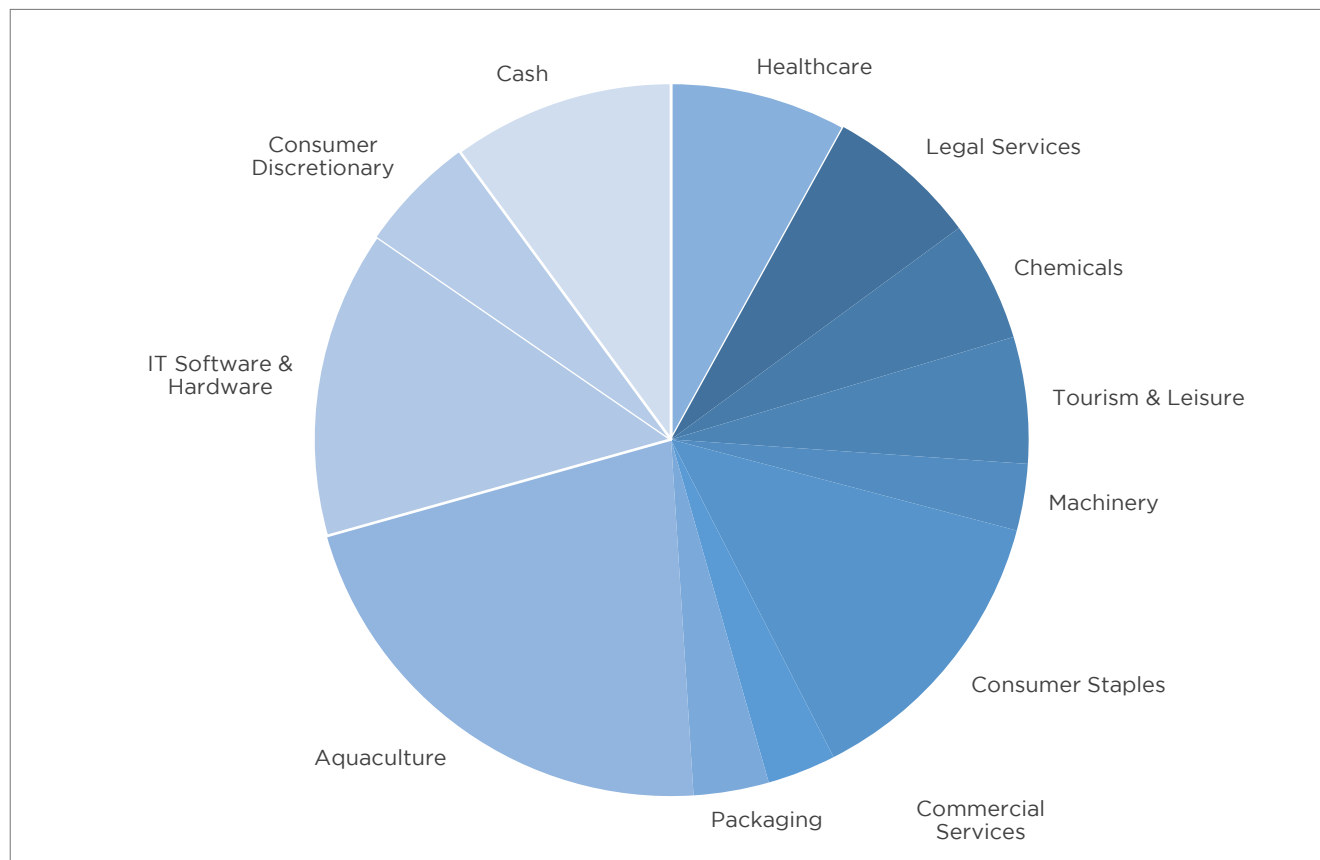
FBR raised \$4m via a placement at \$0.018/share to institutional and sophisticated investors, in which we participated, to be used for working capital and to complete the mechanical assembly of the next-generation Hadrian X (in consultation with Liebherr-Mischtechnik) as per their MOU. Subsequent to the end of June, we note that FBR also received a commitment from Brickworks Limited to invest a further \$1.9m at the same price as the placement. This gives Brickworks at 4.93% stake in the Company and provides further positive validation of FBR's progress and commercial viability of its technology.

PPG announced completion of the sale of its Rigid business on 24 June 2022. However, the Company once again took the opportunity to further downgrade its earnings guidance for FY22, with the business now expected to record a loss of \$2.9m (vs PBT of \$5.0m previously). The key drivers continue to be resin cost increases which cannot be recovered quickly enough via price increases and poor productivity at the relatively newly created 'hard flexibles' plants in Melbourne due to current structural limitations on attracting and retaining skilled labour. PPG noted that the sale of the Rigid business will, by necessity, require restructuring activity focussed predominantly on reducing corporate costs and right-sizing other parts of the business. In addition, the Flexibles business will now be directly managed by the CEO, which PPG believes should translate into improved financial performance. Finally, PPG stated that the business will adopt an acute focus on debt and working capital which may result in a downscaling of some of the Industrials business product portfolio, where the current supply chain risk and product profitability do not appropriately align. While none of these issues are structural, in fact PPG still has the structural tailwind of supply chain onshoring, the cyclical challenges and the pace at which they have taken hold are disconcerting, even for long term investors.

Finally, in other news, there was an interesting article written in the Sydney Morning Herald titled 'Make or brake: The critical test of Albanese's manufacturing vision' on 24 June which highlighted a powerful lesson from the pandemic that Australia did not have the sovereign manufacturing capacity to withstand an emergency. To that end, the author highlighted IDT Australia (IDT, -26%) as the only remaining manufacturer in Australia with a production line that can make active pharmaceutical ingredients (APIs), the core chemicals (e.g. paracetamol) in most of the pills we take. While many pills are made in Australia, most rely on APIs that come from overseas with the ingredients already prepared. The article went on to state that the new Government is reviewing the Modern Manufacturing Initiative (there are unspent funds) as well as setting up a \$15 billion National Reconstruction Fund, with \$1.5 billion set aside for medical manufacturing. This may (inexplicably) still amount to nothing for IDT, but with the stock trading around NTA (cash and property, plant & equipment), we believe there is minimal downside to holding.

Portfolio characteristics

We currently have ~90% of our capital invested in 16 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 August on our performance during July.

Kind regards,

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