# Emerging Companies Fund

## Monthly Update: January 2023

SAVILLE CAPITAL

Dear Fellow Investors,

Our Emerging Companies Fund was broadly flat (-0.2%) in January vs +7.2% for the Emerging Companies Accumulation Index (XECAI) and +6.3% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +10.7% p.a. and a total return of +84.1% vs +79.6% for the XECAI and +36.6% for the XSIAI.

January saw risk appetite return to global markets on the back of further indications that inflation is declining sufficiently for the Fed to pause imminently, with many market indices enjoying very strong returns. Unfortunately, those buoyant conditions didn’t fully cascade down to micro-cap industrials. While frustrating given the poor performance over the past 18 months, it is consistent with previous market cycles where the small/illiquid end of the market is a substantial laggard, but also a source of significant upside when it does finally rebound. The XEC headline performance was heavily influenced by resources (the XSR was +10.2% in January), which continue to perform much better than micro-cap industrials. Remarkably, the Fund was in negative territory for most of January, with half of our stocks ending the month lower (again), most notably Imricor (IMR, -32%), which has been under significant pressure as a substantial shareholder is exiting due to the closure of their Fund. Had IMR just been flat for the month, the Fund would have been up over 2%, still not a great outcome, but certainly better than -0.2%. The fact that so many micro-cap industrial stocks continue to de-rate in the face of rising global markets, declining bond yields and improving news flow highlights the damage done to investor confidence following a period of such prolonged and pronounced negative share price performance. The feedback from brokers is that institutions seeking to add risk are more focused on the mid-cap growth stocks and small resources, with most yet to feel compelled to buy back into micro-cap industrials. Conversely, they are still seeing selling pressure from micro-cap managers that have suffered redemptions and retail investors that have lost patience.

Nonetheless, on the positive side, we received some encouraging quarterly updates from several of our key stocks towards the end of January, which not only helped pare most of the Fund’s decline for the month but should underpin what we hope will be a period of better performance. As an example of how sharply things can turn at the individual stock level, Marley Spoon (MMM, +19%), which has been the bane of our existence for the past 18 months, not only had a bounce but has continued that momentum into February on the back of generating €5m of EBITDA in the December quarter (ahead of consensus) as well as the emergence of a German VC Fund (468 Capital) as a substantial shareholder (~20%). MMM is already up >40% in February and now up +73% since the start of January, demonstrating the embedded potential in the Fund as this cleansing process concludes, confidence returns and our investments start to re-rate back towards their intrinsic value.

## 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% | +10.1% | -0.3% | -6.1% | +2.0% | -3.8% | -6.7% | -49.9% | | |
| 2023 | -0.2% | | | | | | | | | | | | -0.2% | -10.3% | -45.8% |

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

## Performance commentary

The key positive contributors during January were Mighty Craft (MCL, +19%), Marley Spoon (MMM, +19%) and Dropsuite (DSE, +17%). The key negative contributors were Imricor (IMR, -32%), Pentanet (5GG, -17%) and Terragen (TGH, -9%).

As mentioned, MMM delivered its first positive EBITDA quarter since CY20 and its highest-ever quarter of EBITDA. While MMM's revenue growth has temporarily slowed (guidance is for single-digit growth in CY23), this has been a deliberate decision to preserve cash through less marketing spend. Meanwhile, after a period of inflationary headwinds, contribution margins continue to improve, a trend which is expected to persist into CY23 (guidance is 30-32% vs 28.7% in CY22). All of this has translated into guidance for positive EBITDA in CY23, with incremental improvement in its cash flow and funding position from 2Q CY23 onwards. Interestingly, the key personnel behind 468 Capital were early investors in Hello Fresh and would have a deep understanding of the meal kit industry.

DSE reported another strong quarter of revenue growth and margin expansion, with 4Q CY22 Annual Recurring Revenue (ARR) of $25.4m, up +10% on the prior quarter and +58% on pcp. Product gross margin of 70% was up 4 percentage points and monthly ARPU was up +4% on the prior quarter. This all culminated in delivering a third consecutive quarter of positive cash flow ($0.45m). DSE ended CY22 with $22.3m in net cash, guiding to ongoing positive EBITDA/cash flow in CY23, underpinned by implied guidance of ~40% ARR growth. This will be achieved via a combination of increased penetration of existing MSP customers, the addition of further MSPs, new product development and targeted M&A.

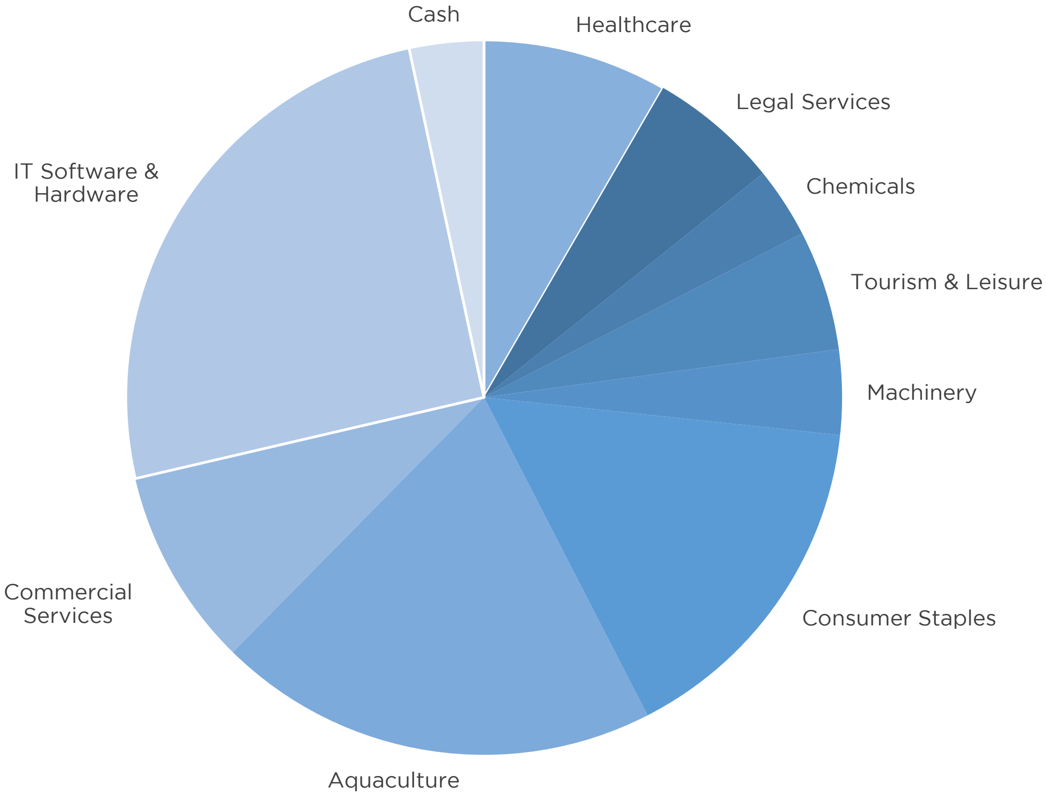
MCL delivered a record quarter on several fronts, including revenue of $31.2m (up +91% vs pcp) and positive operating cash flow of $1.6m (the first positive result since listing in December 2019). This is a significant milestone for the Company and reflects the increasing scale across the business, the ongoing incredible performance of Better Beer (selling 3.2m litres in FY23, +687% on pcp) and a disciplined approach to cost control. Apart from Better Beer, the key growth drivers were 78 Degrees and Kangaroo Island Spirits, as well as its hospitality venues, which generated 18% EBITDA margins during the quarter. Given the current momentum across the business, MCL was very upbeat about its outlook for 3Q FY23 but remains committed to balancing revenue growth with cash flow, while simplifying the business through its divestment program of non-core assets.

Ansarada's (AND, +4%) 2Q FY23 revenue was flat on pcp (+2% QoQ), an excellent result given the significant headwinds it faced through depressed deal volumes (-30% on pcp). This enabled AND to generate positive operating cash flow of $2.7m, ahead of its guidance for negative cash flow. In addition, while subscribers were understandably lower (-8% on pcp), AND was able to deliver record customer numbers (includes freemium), up +66% on pcp, helping to underpin a strong rebound in revenue when deal volumes inevitably normalise. With gross margins of ~95%, positive cash flow, a rapidly growing customer funnel for new subscribers, net cash of ~$19m and industry tailwinds likely to return in 2H CY23, we consider AND to be one of the standout opportunities within the Fund. Its share price has almost halved over the past year, yet the fundamentals of the business are unchanged; in fact, the resilience of the business model has surprised on the upside. It also remains fully funded, is leveraged to improving markets and, in our view, would be of significant appeal to larger software businesses that service a similar client base. Despite this, based on our forecasts AND is trading on <2x FY24 revenue and ~10x FY24 EV/EBITDA, which is very undemanding for a global software business generating >$50m in revenue at such high margins and with an addressable market of >$50bn.

Finally, 5GG saw a 25% increase in revenue (+6% QoQ) during 2Q FY23, underpinned by a +15% increase in telco subscribers and a +405% increase in GeForce NOW cloud gaming memberships. With neXus now operating with an average uptime of 98.8%, the Company expects an acceleration in subscriber growth as it activates already installed neXus units. 5GG also implemented cost control measures, reducing the advertising-to-revenue ratio from 8% down to 5%, and overheads by 2%, with EBITDA losses declining by 20% QoQ.

## Portfolio characteristics

We currently have ~97% 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 March on our performance during February.

Kind regards,


Jonathan Collett

Principal

Saville Capital

+61 3 9769 1789

jcollett@savillecapital.com