

# Emerging Companies Fund

Monthly Update: September 2023



Dear Fellow Investors,

Our Emerging Companies Fund was down -5.6% in September vs -4.9% for the Emerging Companies Accumulation Index (XECAI) and -5.0% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +7.6% p.a. and a total return of +62.2% vs +58.5% for the XECAI and +30.7% for the XSIAI.

September was a very weak month for global markets, largely driven by this renewed surge in bond yields we have observed, particularly long duration (the Australian 10yr bond yield finished the month at 4.5%, up from 4.0% on 1 September). Unfortunately, when the “risk-free” return on capital is climbing at such a rate, the incentive for investors to buy equities significantly diminishes and the appeal of rotating out of equities into bonds or fixed income increases. While on face value, the sharply rising bond yields would imply that the market expects high inflation to persist, some macro research we have read suggests that there are other factors at play (e.g. supply significantly exceeding demand for recent Government bond issuance), which should gradually neutralise.

It is easy to get worn down by the prevailing (and persistent) negativity, but it’s important to remember that all markets go through cycles and this bear market in micro/small caps has been in place for almost two years now, which is their typical duration. Furthermore, macro forecasters/central bankers have a long history of extrapolating current trends (be they negative or positive), rather than identifying the “economic shock” lurking just beyond the horizon. While we can’t identify the exact catalyst for bond yields/rates to reverse course, it seems logical that the higher rates go (and for longer), the more likely it is that something unforeseen will occur and a sharp reversal may follow. In the meantime, we will continue to focus on what we can control, which is analysing the operational and financial performance of our existing positions and assessing potential new additions.

To that end, we are very optimistic about the next six to 12 months for the Fund, with many of our stocks now rapidly approaching key catalysts which we expect will validate our investment thesis and reward our patience with significant positive share price performance. Most of our investment positions are added with at least a 3-year investment horizon in mind, and our portfolio now contains many stocks which we have held for at least two to three years. While we always welcome (and prefer) that our investment thesis plays out earlier rather than later, thus allowing rotation into another compelling proposition, the impact of COVID lockdowns, subsequent supply chain issues and very weak capital markets has definitely elongated the typical journey of micro-cap companies towards delivering on their objectives and fulfilling their share price potential.

## Performance summary

|             | Jan   | Feb    | Mar    | Apr    | May    | Jun    | Jul    | Aug    | Sep   | Oct    | Nov   | Dec   | Total  | 3M     | 12M    |
|-------------|-------|--------|--------|--------|--------|--------|--------|--------|-------|--------|-------|-------|--------|--------|--------|
| <b>2017</b> |       | -3.2%  | +2.6%  | -0.6%  | -1.0%  | +7.6%  | +6.4%  | +2.7%  | +4.0% | +13.2% | +9.5% | +8.1% | +60.1% |        |        |
| <b>2018</b> | -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%  |        |        |
| <b>2019</b> | +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% |        |        |
| <b>2020</b> | -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% |        |        |
| <b>2021</b> | +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% |        |        |
| <b>2022</b> | -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% |        |        |
| <b>2023</b> | -0.2% | -8.1%  | -6.1%  | +6.1%  | -5.4%  | -7.8%  | +21.2% | -3.7%  | -5.6% |        |       |       | -12.3% | +10.2% | -19.6% |

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

## Performance commentary

The key positive contributors during September were Bluechiip (BCT, +25%), FBR Limited (FBR, +23%) and Ansarada (AND, +4%). The key negative contributors were Imricor (IMR, -22%), Pentanet (5GG, -24%) and Fleetwood (FWD, -12%). There were no material items of news flow for our portfolio stocks during September.

### Company in focus: Vysarn Limited (VYS)

VYS is focused on the integration and development of water specialised services and technologies, comprising four divisions: Pentium Hydro, Pentium Test Pumping, Pentium Water and Project Engineering. VYS first entered the water service industry in April 2019 via the acquisition of Ausdrill's waterwell drilling assets and inventory for \$16m. Since then, it has built a vertically integrated model that provides 'end-to-end' water services to various sectors including resources, urban development, utilities and agriculture.

Pentium Hydro operates Australia's largest dual-rotary fleet and is the only provider to offer all three forms of hydrogeological drilling (dual-rotary, dual tube flooded reverse and conventional), underpinned by a Tier-1 mining customer base (BHP, Roy Hill and FMG) and multi-year, multi-rig contracts. Dewatering is an operational imperative where aquifers or water tables intersect the ore body of a planned or operating mine site. This is a particular issue in the Pilbara region of WA where 65% of resources are below the water table. Unlike exploration, hydrogeological drilling is largely immune to commodity cycles as it is an operational requirement for most operating mines in the Pilbara, with continuous pumping required to keep groundwater levels suppressed and the mine pit dry.

Pentium Test Pumping (PTP) provides critical test pumping and injection testing services that follow drilling in the dewatering, mine planning and expansion processes. Test pumping and injection testing gathers valuable data on the underlying aquifers, individual well and bore-field performance, that guides the removal and reintroduction of water. PTP's technology allows customers to remotely access the equipment, supplies live data and provides interpretative hydrographic displays that not only allows for safe and effective operations but also informs decision making on mine expansion decisions.

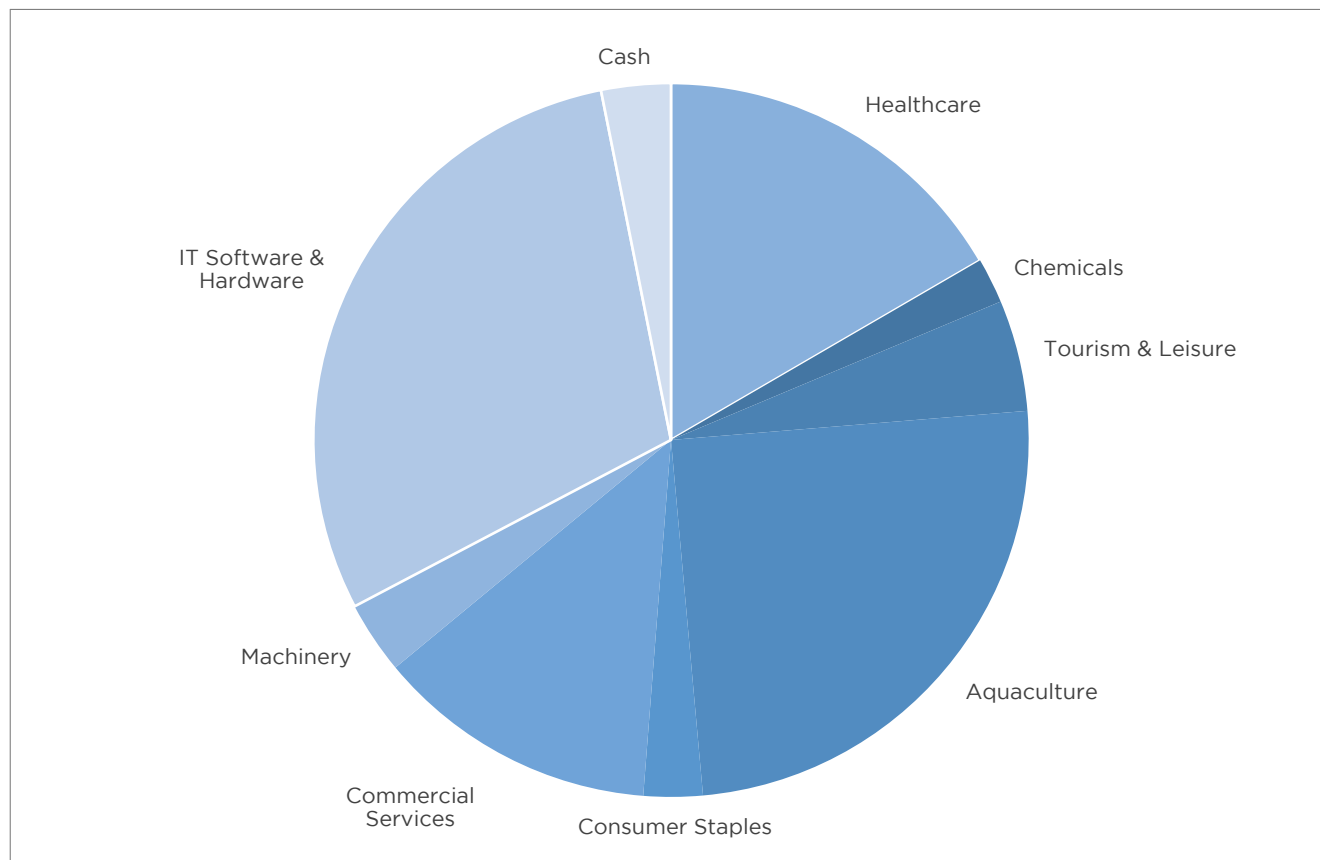
VYS's Project Engineering (ProEng) division designs, manufactures and operates its own unique managed aquifer recharge (MAR) units. ProEng has a market leading position due to its patent pending one-way 'pro-charge' injection valve. The valve operates at high water pressures and links directly to the business's proprietary software and control systems above the MAR unit to respond to changing hydrogeological conditions. ProEng's innovative two-way valve technology will soon be available to provide its operators with greater control and flexibility over flow rates, recharge and extraction, which will support customers to adhere to increasingly strict water management regulations.

Finally, VYS's water consulting unit, Pentium Water, is comprised of hydrologists and water professionals that allow work to be won across the entire water vertical from mine closure through to ownership, infrastructure and environmental planning. Whilst this is a source of a solid earnings growth for the group, more importantly, it plays an essential role in VYS's group strategy and capital allocation decisions. The efficient and environmentally responsible management of water is a critical issue that we expect will continue to present significant growth opportunities, both vertically and horizontally.

We first acquired a stake in VYS during August, impressed by our meetings with what we believe is a strong management team. The business is profitable/cash flow positive, generates a solid (and rapidly improving) return on capital, has a healthy balance sheet and will continue to drive earnings growth via greater asset utilisation (e.g. double shifts), pushing further upstream (e.g. more high margin consulting revenue) and accretive acquisitions. Trading on ~6x FY23 EV/EBITDA and ~4x FY24 EV/EBITDA, we think it offers compelling value given the potential for a combination of multiple expansion (particularly as it generates more high margin revenue) and continued strong earnings growth.

## Portfolio characteristics

We currently have ~97% 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](mailto:jcollett@savillecapital.com)

### Important Information

*One Funds Management Limited ("OFML"), ACN 117 797 403, AFSL 300337, is the issuer and trustee of the Saville Capital Emerging Companies Fund. The material contained in this communication is general information only and was not prepared by OFML but has been prepared by Saville Capital Pty Ltd ("Saville Capital"), a Corporate Authorised Representative of One Investment Administration Ltd ("OIA"), ACN 072 899 060, AFSL 225064. Saville Capital has made every effort to ensure the accuracy and currency of the information contained in this document. However, no warranty is made as to the accuracy or reliability of the information. Investors should consider the Information Memorandum ("IM") dated 23 December 2016 issued by OFML before making any decision regarding the Fund. The IM contains important information about investing in the Fund and it is important investors obtain and read a copy of the IM before deciding about whether to acquire, continue to hold or dispose of units in the Fund. You should also consult a licensed financial adviser before making an investment decision in relation to the Fund. Past performance is no guarantee of future performance. This report does not take into account a reader's investment objectives, particular needs or financial situation and is general information only to wholesale investors and should not be considered as investment advice and should not be relied on as an investment recommendation.*