Emerging Companies Fund

Monthly Update: May 2024

Dear Fellow Investors,

Our Emerging Companies Fund was down –5.4% in May vs +0.6% for the Emerging Companies Accumulation Index (XECAI) and –0.9% for the Small Industrials Accumulation Index (XSIAI). Since inception, the Fund has generated +5.2% p.a. and a total return of +44.8% vs +83.0% for the XECAI and +47.7% for the XSIAI.

May was just a repeat of the last two months where headline index moves were benign, but the micro-cap segments within them were sold off. Reverting to our analysis of the XEC again, the median performance of the <$250m market cap segment was -7.4% (mean was -6.4%) and the <$100m was an incredible -12.7% (mean -10.8%). While it is a continuation of a remarkably persistent trend, we think it was exacerbated by tax-loss selling which typically runs from mid-May through to mid-June. With many parts of the market having experienced a positive year, micro-caps that have delivered negative performance in FY24 would be a very logical target for those investors seeking to offset taxable gains elsewhere. The silver lining is that because the price moves are based on temporary factors, we usually see a sharp bounce back in July. Last year the Fund was up +21.2% in July and the average of the last five years has been +11.4%.

Given the ongoing weak performance of the Fund, we wanted to reflect on how we got here and why we are still very confident that it will rebound strongly over time, noting we again materially increased our investment in the Fund at the end of May. As we have previously highlighted, over the past few years we have been caught in by far the worst part of the market, driven by a rapid change in bond yields/rates (which have now stabilised) that has temporarily sucked all confidence and liquidity out of the micro-cap sector. Given our strategy is to have a portfolio with an average market cap of ~$100m, excluding commodity-based stocks (many of which have fared well during this cycle), the Fund has been severely impacted by this phenomenon. Exacerbating this headwind is our preference to own long-term structural growth stories that may require more capital to achieve their potential, with a commitment and discipline to hold through the cycle. So rather move with the herd and sell out of these stocks to avoid the temporary share price weakness, we have added to them by supporting each capital raise during this period. This creates a double negative as stocks that were already under pressure, raise capital at a steep discount (to attract support) and then face even more selling in the aftermath as some investors trade them for a quick profit, often driving the shares to below the issue price. This has nothing to do with the merit or value of the underlying business, it is just the mechanics of this market. Pleasingly, capital raises are now attracting a greater breadth of institutional support, which we see as a precursor to institutions starting to buy more micro-caps on market, offsetting and then overwhelming the persistent retail selling.

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%	-8.1%	-6.1%	+6.1%	-5.4%	-7.8%	+21.2%	-3.7%	-5.6%	-1.8%	+3.9%	+2.6%	-8.1%		
2024	-0.9%	-4.8%	+1.1%	-5.6%	-5.4%								-14.8%	-9.7%	-9.4%

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

Performance commentary

The key positive contributors during May were Vysarn (VYS, +17%), IDT Limited (IDT, +5%) and Dropsuite (DSE, +1%). The key negative contributors were Murray Cod Australia (MCA, -21%), Bluechiip (BCT, -14%) and FBR Limited (FBR, -7%).

Subsequent to month end, IDT received a non-binding takeover bid for $0.15/share from Mynd Biotech (global manufacturer and distributor of psychotropic medicines), coupled with a $7m capital raising at $0.09/share to fund some capital equipment upgrades and working capital for the Sanofi contract. Given IDT was trading at $0.10 at the end of May, and as low as $0.055 as recently as November last year, the bid comes as welcome news and is further evidence of the persistent and significant mispricing within the micro-cap segment. While we would be very surprised if the Board decided to progress to a Scheme of Arrangement with that bid price, it does now put the Company in play. We think this could draw out strategic interest from multiple other parties (including from offshore) that would see significant value in owning a GMP-certified and TGA licenced facility (FDA, PMDA, EU & ODC Qualified) in Australia, particularly given it has an NTA of ~$0.08/share and a replacement value of $0.24/share. Having added to our position in recent months following management's progress in turning around the business, it ended May at ~10% of our portfolio, so IDT has the potential to be a strong contributor to our performance over the coming weeks/months as events continue to unfold.

VYS announced that its wholly owned subsidiary, Vysarn Asset Management (VAM), has entered into a Joint Resource Agreement (JRA) with the Kariyarra Aboriginal Corporation RNTBC (KAC). KAC holds the traditional cultural interests in all water resources on Kariyarra country, which covers a large area encompassing Port Hedland. Under the terms of the JRA, KAC and VAM will be equal partners in establishing and operating an exclusive JV for the purpose of investigating, assessing, managing, owning, controlling, extracting and selling water from identified and secured water resources on Kariyarra country. VYS will also be appointed the JV manager and marketer of all quantities of water that the JV secures and develops. We see this as a key catalyst for VYS and is a source of significant earnings and valuation upside for the business as, and when, it starts developing and operating these potential water assets for which there is already substantial unmet demand at very attractive pricing and unit economics in that region.

We experienced another capital raise during May, with MCA raising ~$20m at $0.07/share (vs previous close of ~$0.10 and NTA of $0.09) to fund its ongoing working capital and infrastructure investment. As we touched on last month, we had hoped that MCA would be able to vend some of its property and water rights into its recently established Australian Sustainable Protein Fund (ASPF), thus alleviating the need for an equity raise. However, we understand that while it was in advanced discussions with a number of parties, the further negotiations progressed, the clearer it became that it wasn't going to be able to conclude the process quickly enough to avoid raising equity in the interim. Pleasingly, the capital raise was very well supported by existing and new institutions and the stock is trading well in the aftermath. Furthermore, it removes the risk of being pushed into accepting a price for a large asset well below its market value. The plan is now to run a separate sale process for the Stanbridge site (with a leaseback) while negotiating with the most suitable partner for the ASPF to help fund future developments. Hopefully the market now shifts its focus away from MCA's funding position and towards its significant production and sales growth over the next few years as it moves to profitability.

Following a disappointing update regarding the integration of its PaulCamper business, we decided to exit our position in Camplify (CHL). While we remain attracted to the model and financial metrics of the core business (particularly in Australia/NZ), we are concerned that the PaulCamper acquisition has the potential to undermine this. We accept that the integration issues may prove to be temporary, and there is significant upside if management can execute on their plans/target. But having seen major acquisitions cause persistent problems for other businesses in the past, we have decided we would rather watch from a distance for now, rather than participate in the journey.

Company in focus: Airtasker Limited (ART)

We recently added ART to the Fund, partly to replace Ansarada (AND) which we have now sold out of ahead of the approval process for its takeover bid. ART, established in 2011, provides an online marketplace for the posting and performance of local tasks and services in Australia (primarily), the UK and US. The platform connects consumers to taskers to complete jobs ranging from those in existing industries, to idiosyncratic jobs that exist primarily as a result of a platform such as Airtasker enabling them. The platform accounts for all parts of the interaction (save the physical completion of the task), including payments, insurance and any reviews/complaints. The platform has since inception seen >1.3 million unique paying customers, 180k taskers and >$2b of task value flow through the platform, culminating in 64% brand awareness in Australia alone.

ART is a founder-led business (CEO and co-founder, Tim Fung, still owns >10% and Board owns >50%) that listed in March 2021 with much fanfare. The IPO, priced at $0.65/share, was >5x oversubscribed (including many institutional investors) and debuted with a share price of $1.43. However, like so many other micro-caps (particularly those which were loss-making), it suffered a significant de-rating over the following 2.5 years, hitting a low of ~$0.17 in October 2023 (now $0.25). Earlier that year (in April 2023), ART announced a program to reduce costs and focus on more efficient scaling of the core Airtasker marketplaces. This included reducing global headcount by 20% (primarily in non-revenue generating functions) and exiting non-core businesses. These changes led to the business becoming both profitable and free cash flow positive in 1H FY24.

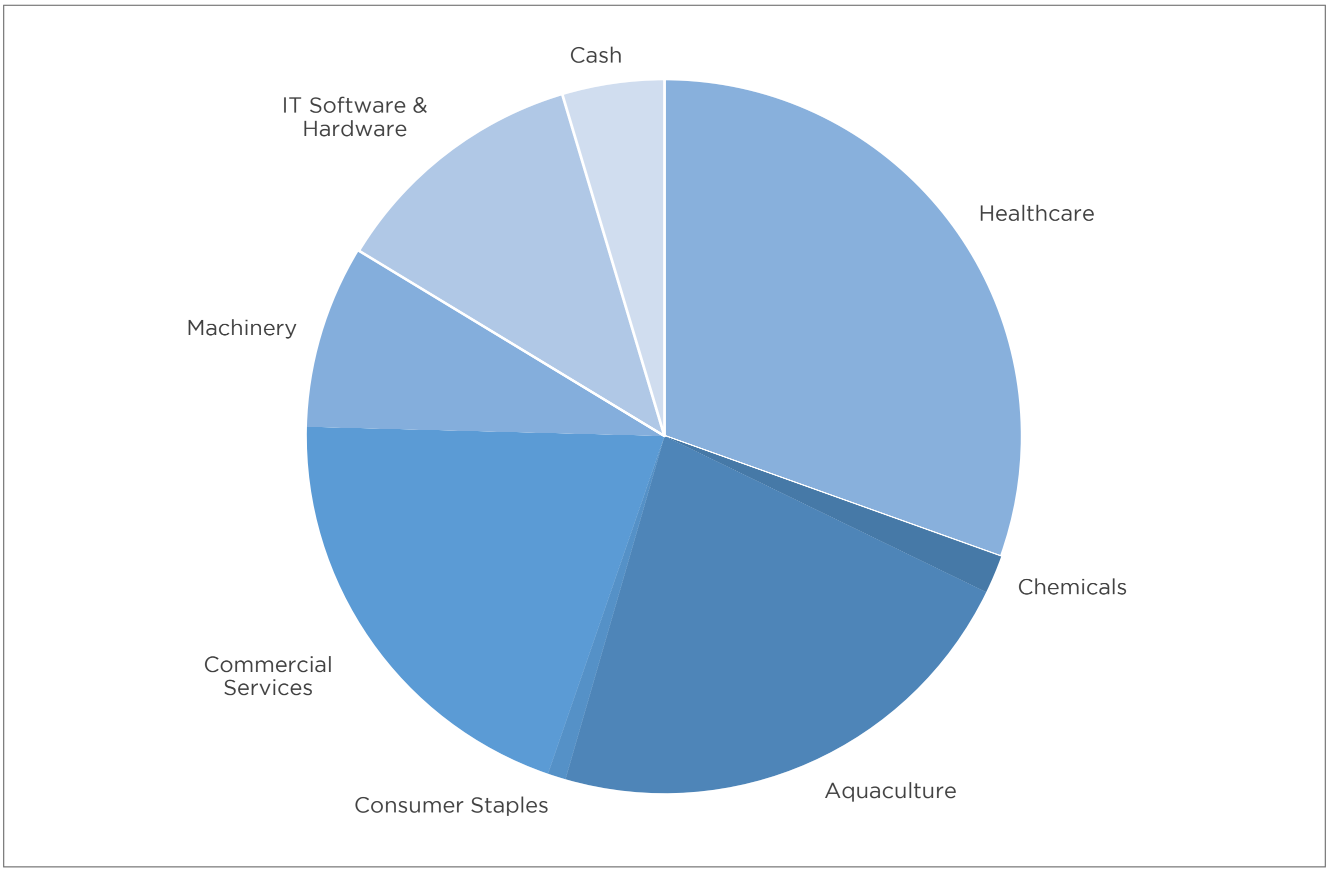
This trend of profitability continued into its most recent 3Q FY24 result, which was aided by successful funnel optimisation programs, including a revised cancellation policy designed to improve platform reliability and address task leakage. These programs saw cancellations reduce by 24% on pcp, resulting in the monetisation rate improving by 13% on pcp to 20.5% (with scope remaining for further improvement). In addition, its increasing focus on the UK market (with the recent launch of a significant marketing campaign – more on this below) saw posted tasks (key leading indicator) up +49% on pcp in that market. Importantly, the Australian business generated net EBITDA of $3.9m for the quarter, which means that on an annualised basis the implied market value of that business is just ~6x EV/EBITDA (assuming zero value for the UK and US). While the Australian business has struggled for growth in recent years, this has been due to a lack of labour availability as a result of COVID (when international students left Australia) and low levels unemployment – both of which are now in the process of unwinding.

A key strategy to build its marketplace in Australia was a media-for-equity partnership between Airtasker and Seven West Media. This partnership enabled Airtasker to build a trusted household brand name and scale network effects rapidly, resulting in 20x revenue growth and a 5x investment return for Seven West Media over 5 years. This model is now being replicated by Airtasker to drive rapid scale in the UK. In June 2023, it formed a 5-year media-for-equity partnership with Channel 4 in the UK which provides Airtasker with an initial $6.7m in advertising media and access to Channel 4's reach of 47 million UK people (78% of the UK population). Seasonally, marketplace activity in the northern hemisphere is strongest in the third and fourth quarters, during spring and summer, so we will watch the next two quarters with great interest.

Following its strong 1H FY24 result, the stock started on what we expect will be a journey back to its IPO price (and hopefully beyond). The business generates stellar gross margins (~95%) and is now modestly profitable/cash flow positive despite still being in a growth phase, and has a healthy balance sheet (~20m in net cash). While we expect continued solid growth in its Australian business, we think the key catalyst could be demonstrable progress in the evolution of its UK marketplace, which we believe has already started, followed by a similar media-for-equity partnership deal in the US market.

Portfolio characteristics

We currently have ~95% of our capital invested in 11 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 July on our performance during June.

Kind regards,

Jonathan Collett
Principal
Saville Capital

+61 3 9769 1789
jcollett@savillecapital.com

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