Issue 22: February 2017

JM Financial Group

Small Companies Strategy – Investment Newsletter

Performance (As at 28th February 2017)	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**-0.06**	**-0.56**	**-0.56**	**+3.03**	**+16.31**	**+57.83**
Small Ords Accum. Index	+1.31	-1.17	-1.17	+4.60	+16.77	+20.19
Outperformance	**-1.37**	**+0.61**	**+0.61**	**-1.57**	**-0.46**	**+37.64**

Although the JMFG Small Companies Strategy is generally representative of client portfolios, Individual performance may differ from the results above. These differences can arise due to various issues, some of which may relate to initial timing of investments and cash inflows and outflows. Performance is calculated on TWRR basis; non- annualised, excludes fees and the effects of franking credits and tax. Strategy Inception for Performance Data is July 1st 2014.

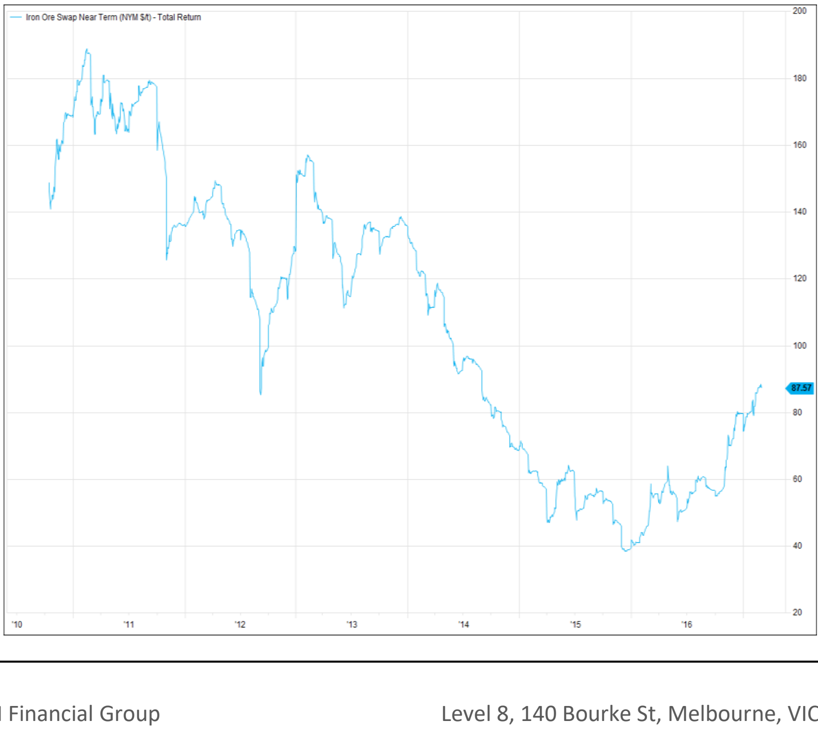
***Month in Review-** A review of events that influenced the share market in February.*

February saw the ASX 200 rise 2.3% and the Small Ords Index rise 1.3%, reversing losses experienced in January. The Dow Jones surged through 20,000 points, finishing the month above 20,850. Reporting season proved to be good, with only a limited number of sizeable negative surprises. Confession season through January dealt with several negative surprises: Telstra & Brambles amongst the majors with iSentia, ARB Corporation, Ardent Leisure, Spotless Group, and Retail Food Group amongst some of the larger Small Ords companies. Guidance statements were generally in line with or ahead of expectations. The market was stronger in the first half of the month, retreating partially later in the month.

The Resource Sector eased in February, having been in a strong upward trend for a full 12 months. Commodity prices were generally stronger through the month with iron ore price up ~10% and nickel a similar amount. Copper rose marginally but energy prices weakened slightly. The Resource Sector does not look expensive on current estimates but estimates are now based on stronger commodity prices and as such risks have increased. If improved U.S. growth expectations are achieved, stronger commodity prices may be maintained through 2017. Iron Ore prices may be harder to maintain through 2017 following inventory re-stocking in China and growing global supply. Downside risks in the Iron Ore space would seem much higher than other resources but there are no signs of a price reversal at this stage.

Market PE multiples above 16x in FY17 based on forecast EPS growth of ~8% is not excessive, as we highlighted last month, particularly if backed up by a further 7-8% growth in FY18 as is currently forecast by the market. If Resources are excluded from the equation, along with lower PER Banks (13-14x avg), Property Trusts, and highly geared Utilities, the underlying multiple for Industrial companies is in the 19-20x PER range. Solid growth needs to be achieved to support such multiples but within the smaller cap space both higher growth and lower multiples provide attractive opportunities in a growth backdrop.

Chart of the Month – The Rise Of Iron Ore



Iron Ore has made a solid recovery, more than doubling from a low base. Some recovery needed to occur. Prices around US$40/t were unsustainable given lowest cost global operators in Australia, BHP and RIO, have all-in costs in excess of US$30/t for their high grade ore production. Many global peers, by comparison, have cost structures well north of US$50/t for what is often considered inferior grade ore.

Whilst one can never say never, it is difficult to envisage iron ore prices back above US$160/t as seen in 2010 and 2011. Cost structures globally have come down dramatically since 2012, coinciding with rising supply and falling prices, with costs falling by as much as 50%. High end cost operators are typically in the US$60-80/t range.

As it stands today even the highest cost operators are generating returns and this should drive further growth in supply over time. While the iron ore price may go higher it could well be capped in the vicinity of US$100/t.

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Best & Worst Performers for February 2017

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Mayne Pharma - MYX	Datetix Group - DTX	Seven Group Holdings - SVW	Isentia Group - ISD
Class Ltd - CL1	Stokes Ltd - SKS	Lynas Corporation - LYC	CSG - CSV
Maxitrans Industries - MXI	Godfreys Group Ltd - GFY	Costa Group Holdings - CGC	Ten Network Holdings - TEN

***Hits & Misses –** A summation of the top hits and misses for the month of February*

Mayne Pharma – up 17% for the month

A good interim result helped offset recent negative press surrounding the Antitrust Division of the US Department of Justice investigating anti-competitive behaviour in relation to marketing, pricing, and sales of select generic products.

Seven Group Holdings – up 36% **(Not held)**

Improved earnings from its Industrial Services division more than offset deteriorating earnings from its interest in Seven West Media and recent negative publicity surrounding the Seven West Media CEO.

DateTix Group – down 22% for the month

While its half year result reported strong revenue growth, albeit from a low base, it was not enough to excite the market against a backdrop of operating cash burn in the vicinity of $750,000 during the December quarter.

Isentia Group – down 41% for the month (**Not held)**

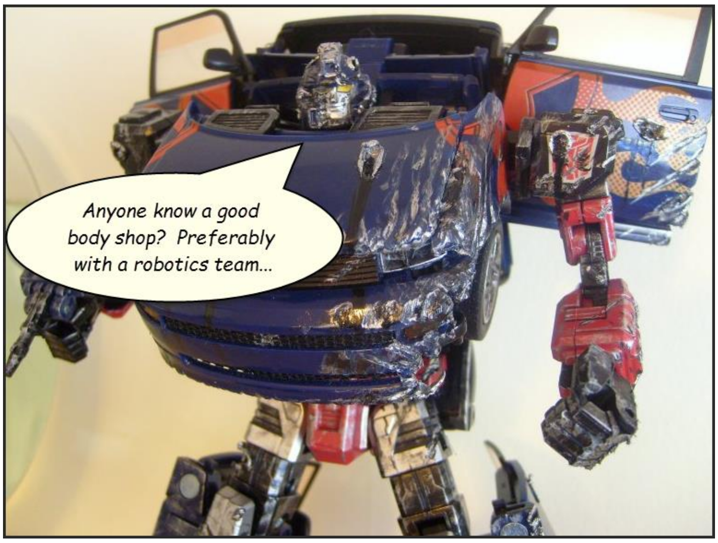
Slow growth in their core SaaS business (higher churn and inability to hold price increases), declines in Content Marketing, and rising costs saw EBITDA decline 13%. Two earnings downgrades in three months leaves little confidence around quality of the business.

Due Diligence – *a closer look at a stock of interest*

AMA Group (AMA) - Crashing Through

The Vehicle Panel Repair segment represents over 80% of AMA's revenue and earnings, with small segments Vehicle Protection (Bullbars), Automotive Electrical & Cable, and Automotive Components producing the balance of revenue and earnings. The thesis for AMA Group is one of consolidation. AMA currently has around 13% share of panel repairs Australia wide and has achieved this through a combination of organic growth and acquisition.

AMA is on an aggressive path to consolidate the Panel Repair business in Australia through both acquisition and "greenfield" development. There are many benefits of industry consolidation. These include:



- Efficient purchasing of product – essentially volume discounts on paint purchases at this stage.
- Investment in streamlined panel repair centres providing fast turnaround times – up to $2m investment per centre.
- Agreed volume deals with insurance companies to maintain high facility utilisation.

The panel industry has already consolidated from 6,000 locations over the last decade to around 3,000 current. Further consolidation however is expected to see this decline to nearer 1,000 over the next decade with many smaller operators driven out due to the cost to re-invest in efficient processes and inability to achieve volume discounts at the same level as the large buyers. Ultimately, AMA Group expects to achieve around 30% market share and with this AMA could potentially vertically integrate into auto parts distribution providing both further savings to vehicle repair (a benefit to insurers and consumers in terms of lower premiums) and a benefit to AMA Group in terms of another growth path, and further justification for industry consolidation.

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