JM Financial Group

Issue 23: March 2017

Small Companies Strategy – Investment Newsletter

Performance (As at 31st March 2017)	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**2.43**	**1.86**	**1.86**	**5.53**	**16.38**	**61.67**
Small Ords Accum. Index	2.66	1.46	1.46	7.39	13.67	23.39
Outperformance	**-0.23**	**+0.40**	**+0.40**	**-1.86**	**+2.71**	**+38.28**

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 March.*

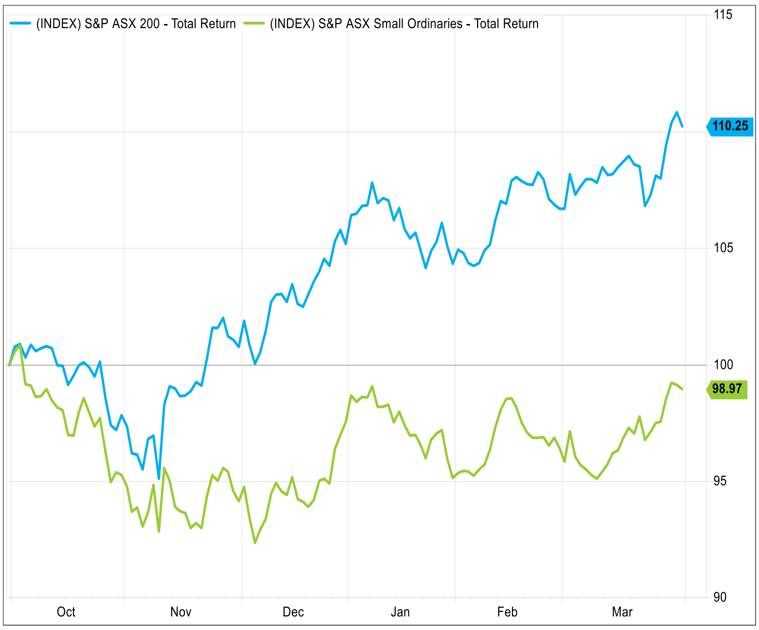
March saw a further solid sharemarket rise, following on from good gains in February. The ASX 200 Accumulation Index rose 3.3% and the Small Ords Accumulation Index 2.7%. Improvements in the Australian market were achieved despite a 0.7% decline in the Dow Jones to 20,663. Leading sectors included Consumer Discretionary, Consumer Staples, Energy, Healthcare, and Utilities, each rising around 5%. Lagging sectors included Telecommunications, REITs, Materials, and Resources; the latter two declining over the month.

No clear market theme is apparent with a mix of cyclical and defensive sectors appearing both within the outperforming and underperforming categories. It would appear to be a stock pickers market for now. The yield play ran out of steam mid 2016 with broad reversals since then. However we did see stocks like Transurban (TCL) and Sydney Airport (SYD) rebound strongly in March. These stocks, whilst attractive yield plays, offer better growth characteristics than many typical defensive yield plays e.g. REITs.

The JMFG Small Co strategy marginally underperformed its benchmark for the month and marginally outperformed over the quarter and is ahead 2.7% over the 12 months to March. The portfolio's best stocks for the month included Datetix, GUD Holdings, Medical Developments and Base Resources. Worst performers included Stokes Notes, Godfreys, St Barbara and Mainstreambpo Ltd. The last six months has been a more difficult period for small companies with much stronger returns achieved across larger capitalisation stocks.

The rise in the market over the past two months would now see average Market PE multiples for FY17 above 16.5x and pushing towards 20x for non-bank Industrials. Stripping out resource related growth, we estimate growth across the broad Industrial market would be in the mid-single-digit range. We view this as a healthy level of growth in a low interest rate environment, with near term rate rises expected to be only modest.

Chart of the Month – ASX200 vs ASX Small Ordinaries



This month we compare the ASX 200 total return against the Small Ordinaries total return performance over the six month period to 31st March 2017. Both indices are indexed to 100 at the 6 month starting point.

The chart highlights the difficulties the Small Ordinaries index has experienced over the six month period in relation to the ASX 200. There has been a clear rotation over this period out of small companies into larger capitalisation stocks.

The largest driver of the ASX 200 outperformance came from the Financials sector, which generated a total return over the period in the order of 20%. The Materials sector has also been a strong performer generating a circa 10% total return.

The recovery in commodity prices and improved growth outlook for the Financials (post balance sheet recapitalisations) have been large drivers of the index resurgence over the past 12 months. We expect the market to continue its rise but at more moderate levels from here with the Materials space now looking more challenged.

Best & Worst Performers for March 2017

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Datetix Group - DTX	Stokes Ltd - Notes - SKSG	Mesoblast - MSB	Quintis - QIN
GUD Holdings - GUD	Godfreys Group - GFY	Spotless Group Holdings - SPO	Lynas Corporation - LYC
Medical Developments - MVP	St Barbara - SBM	The A2 Milk Company - A2M	Resolute Mining - RSG

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

Datetix Group – up 33% for the month

A solid rebound occurred on the back of news that revenues from its premium matchmaking business increased 195% to $96,000 in February 2017 versus January 2017. The company also announced the opening of its first matchmaking store in London.

Mesoblast – up 37% for the month **(Not held)**

The FDA in the U.S. granted fast track designation for Mesoblast's cell therapy in children with acute graft versus host disease. This was seen as a vote of confidence in Mesoblast's technology. Later in the month Mesoblast raised US$40m.

Godfreys Group – down 7.9% for the month

Resignation of a non-executive director on 23rd March was preceded by selling of up to 50% of his holding. This along with a disappointing interim result in February has had an impact on the share price.

Quintis – down 29% for the month (**Not held)**

The subject of short-seller research claiming the business has a 'Ponzi like structure' and will struggle to service its debts. Quintis responded by confirming its guidance and stating that the short-seller research included substantial and egregious inaccuracies.

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

Netcomm Wireless (NTC) – Delivering to NBN and more

Netcomm manufactures and delivers equipment designed to assist in the delivery of high speed communications. It is currently supplying equipment and services to the NBN to help deliver fixed broadband services to the curb (Fibre To The Curb - FTTC) and fixed wireless services. The FTTC equipment helps to deliver improved speed vs NBN's FTTN. It essentially extends fibre from the node to the curb, with up to four houses connected from each curb-side unit, thereby limiting the length of aged copper wires utilised in the communication delivery process. Fixed Wireless technologies help to deliver the NBN to regional communities, utilising 2.3Ghz spectrum. Essentially fixed wireless helps to limit satellite services to the very remote areas of Australia – it is cheaper than deploying satellite equipment to premises and offers a faster speed.

The upside for Netcomm is the ability to deploy its technologies into other parts of the world. The technologies developed are market leading, which reflects NBN's leading position in building a high speed service network to remote/rural non-densely populated urban areas as well as populated metro regions.

In the FTTC business, Netcomm has received an initial order from NBN that will generate around $28m in revenue from June to August this year, with regular monthly orders expected thereafter. In the wireless business NBN has a stated target to deliver its services via wireless or satellite to between 0.9-1.1m homes. The balance between satellite and fixed wireless will ultimately determine the revenue Netcomm will generate but estimates are in excess of $300m.

An example of the in-street copper infrastructure – One of many reasons deploying fibre as close to the premises as possible is critical.

In terms of international potential, Netcomm believes many opportunities exist worldwide to deliver a wireless solution to regional areas. The company won a contract in November 2015 with one of the two largest USA telecommunications carriers (believed to be AT&T) to connect premises in rural areas to a fixed wireless broadband network. It is estimated that 10% of global communication customers are in regional/rural catchments and the total addressable market is about $80b. In addition, the replacement of copper networks in densely populated areas with a FTTC solution offers a timely and efficient alternative to Fibre to the Premises. Demonstrating this capability in the Australian market should provide Netcomm Wireless large volume opportunities globally.