JM Financial Group

Issue 29: September 2017

Small Companies Strategy – Investment Newsletter

Performance *(As at 30th September 2017)*	Month to Date (%)	Quarter to Date (%)	Cal. Year to Date (%)	Fin. Year to Date (%)	Rolling 1yr (%)	Inception (%)
JMFG Small Co. Strategy	**+1.79**	**+1.48**	**+4.06**	**+1.48**	**-3.04**	**+65.21**
Small Ords Accum. Index	+1.31	+4.41	+5.57	+4.41	+2.98	+27.73
Outperformance	**+0.48**	**-2.93**	**-1.51**	**-2.93**	**-6.02**	**+37.48**

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.

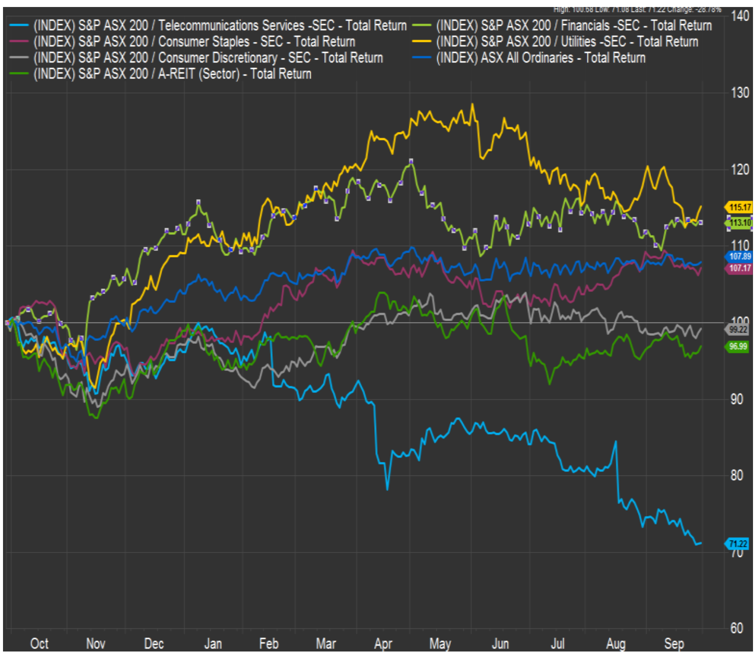
Month in Review- *A review of events that influenced the share market in September*

The JMFG Small Company Strategy increased 1.79% in September, ahead of the Small Ords Accumulation Index which increased 1.31% (ASX Small Resources up 2.43% and ASX Small Industrials 1.05%). Large sectoral moves included Utilities and Telecommunications which fell 3.7% and 4.6% respectively on an accumulation basis. Rising global interest rates affected both sectors, but in the case of Telecommunications ongoing margin pressure in an increasingly competitive environment took its toll. The Materials sector fell 1.6% with Iron Ore falling 20% over the month, to US$61.50/t. On an accumulation basis, most other sectors either fell or rose only marginally.

After a reasonable reporting season, which saw the ASX Small Ordinaries Accumulation Index rise by 2.71% in August, it was encouraging to see a continuation of that trend with a rise of 1.31% in September. Some of our star performers continued to rally with Appen rising from $4.69 to $5.21, having risen from $4.17 in the prior month. HUB24 rallied from $6.55 to $7.85 through September after reporting its first full year profit late August. Other strong performers in the portfolio included GTN, +25%, Temple & Webster, +19%, which continued on from a strong rally in the prior month, and EML Payments +9%. Poor performers included Catapult which fell 24%, on concerns it is not growing at a fast enough pace, while Mainstream BPO fell 19% leading up to a capital raising announcement.

Netcomm Wireless also disappointed, falling 21%. We exited Netcomm Wireless during September following a disappointing result which saw earnings expectations downgraded and delays in timing of a contract delivery. With NBN related contracts due to expire by 2021, there is greater uncertainty around the sustainability of Netcomm earnings post this period. We also exited AMA Group and Super Retail Group during the month, the latter on a successful trade strategy having seen it fall well below valuation. We reduced positions in St Barbara Mines, HUB 24, Base Resources and GTN all on share price strength and added to holdings in Catapult and QMS Media on price weakness. We also added LiveHire to the portfolio, a potential disruptor to existing online job search websites.

Chart of the Month – Challenged Sectors (12m Returns Indexed)



There are several challenged sectors in the Australian market - none more so than Telecommunications, which has underperformed the ASX All Ords by nearly 30% over the past year. Telstra, TPG and Vocus have all fallen dramatically. The ongoing rollout of the NBN and TPG's plans to build its own mobile network make it difficult to see a positive environment for some time.

The Consumer Discretionary & Staples sectors have underperformed. The longer term metrics for these sectors look challenging with the ongoing growth of Aldi / Costco, Amazon on its way and growth of international branded retailers. The Financials sector looks challenged with rising capital requirements and compliance costs, reduction in ATM fees and potential residential slowdown on rising global interest rates. On this latter point, yield sectors such as Utilities and REITs are also likely to face headwinds.

In total these sectors account for around 55% of the Australian market. It highlights the need to be diversified both in terms of sectors and specific stocks with a focus on small high growth stocks in I.T., Health, Materials etc.

Best & Worst Performers for September 2017

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
New Century Resources - NCZ	Catapult Group International - CAT	Pilbara Minerals - PLS	Liquefied Natural Gas - LNG
GTN - GTN	Netcomm Wireless - NTC	Galaxy Resources - GXY	Netcomm Wireless - NTC
HUB24 - HUB	Mainstreambpo - MAI	ImpediMed - IPD	Resolute Mining - RSG

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

New Century Resources – up 29.2% for the month

New Century Resources was added to the portfolio in August and rallied in September on a strong zinc price and increasing realisation of the potential annual cash returns should this existing mine and infrastructure be put back into production as is currently proposed.

Pilbara Minerals – up 78.9% **(Not held)**

Pilbara Minerals rallied on project update information in relation to its Lithium-Tantalum project, scheduled for production start in 4Q17. It also announced an equity injection of A$28m by Great Wall Motor Company and an offtake agreement.

Catapult Group International – down 23.5% for the month

Catapult continued to experience share price declines, with broker downgrades and uncertainty around realistic potential market size, both within the elite sports and prosumer segments.

Liquefied Natural Gas – down 26.2% for the month (**Not held)**

A disappointing profit release late August resulted in the ongoing share price decline, falling from $0.56 to $0.40/share over the course of the month. The company has seen its share price decline from a 12 month high of $0.96 in January 2017.

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

Mainstream BPO (BPO) – Fund Administration Services

Mainstream BPO provides fund administration services, operating under three businesses. It provides:

- Fund administration services for investment managers
- Superannuation administration services for superannuation trustees
- Share registry services for listed companies and exchange traded funds

The company recently announced a $4.1m capital raising in new equity to fund the acquisition of IRESS Superannuation Administration, under a fully underwritten 1 for 12 pro rata accelerated non-renounceable entitlement offer at $0.50/share.

Mainstream has a three-tiered core growth strategy which involves the following:

- Organic growth through the growth of the underlying funds for which it provides administration services
- Accretive acquisitions both domestically and internationally which are complementary to the existing businesses and provide additional high value revenue streams
- Margin improvement achieved through organic growth, accretive acquisitions, improved client experience and efficiencies

Recent acquisitions include Fund Administration Oct 16 (USA), Galileo Nov 16 (Eur/UK), alterDomus Nov 16 (Eur), Trinity Sep 17 (Ire/Cayman Is) and IRESS Superannuation Administration Oct 17 (Aust).

Following a good result MAI shares pulled back from $0.60 to $0.50 over a three week period leading up to the capital raising announcement. We expect the shares to recover over a period of time once the raising is completed.