

Small Companies Strategy – Investment Newsletter

Performance (As at 31 st March 2018)	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	-3.13%	-1.35%	+17.50%	+54.54%	+90.03%
Small Ords Accumulation Index	-2.29%	-2.79%	+14.99%	+35.56%	+41.17%
Outperformance	-0.84%	+1.44%	+2.51%	+18.98%	+48.86%

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 a TWRR basis; non-annualised, and includes fees (post 1 Jan 17) but excludes 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

The JMFG Small Companies Strategy declined 3.13% in March, short of the Small Ords Accumulation Index, which fell 2.29% (ASX Small Resources -4.09% and ASX Small Industrials -1.73%). The Small Ordinaries Index once again outperformed the All Ordinaries Index, which fell 3.55% in March. On all metrics over the past three years, the Small Ordinaries Index has outperformed the broader market. In fact, over a three year period, the Small Ordinaries Accumulation Index has outperformed the All Ordinaries Accumulation Index by over 20%.

Portfolio underperformance during the month was a function of several recent solid performers easing back in March. These included Appen Ltd, Afterpay Touch, which we sold during the month, and New Century Resources. At the other end of the scale, the JMFG Small Company Strategy was not exposed to any of the 14 small company stocks that rose by over 10% during the month. Our best performer, Scottish Pacific, increased 9.2% during March. The Small Ordinaries Index continues to trade at more expensive multiples than the broader market, with its 12 month forward PER at 16.8x compared to 15.2x for the ASX All Ordinaries Index. Over the past several years, the ASX Small Ordinaries has generally traded at a premium to the ASX All Ordinaries.

The JMFG Small Companies Strategy had a relatively quiet month in terms of trading. We added Scottish Pacific to the portfolio and removed AfterpayTouch after a strong rally in its share price. In addition we cut positions in Shriro and SRG Group on share price strength. Overall we increased the portfolio cash position from 14% at the end of February to 17.4% at the end March.

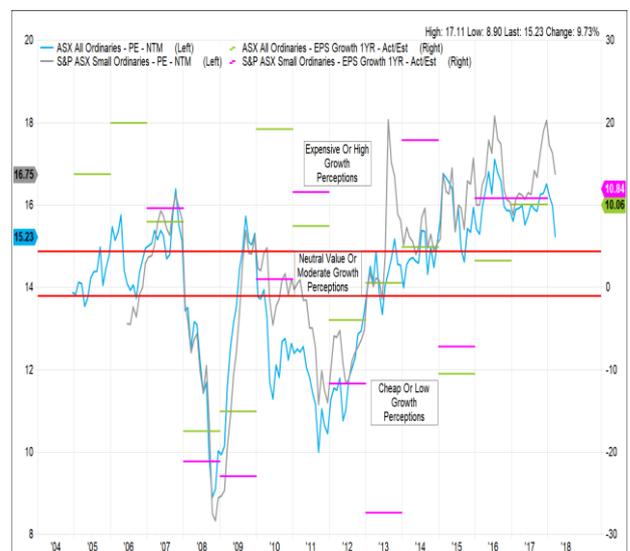
We continue to take a conservative approach with the portfolio. Higher than usual cash levels is a reflection of the relatively high pricing still evident at the small end of the market, increased market volatility seen over the past two months and uncertainties emanating from recent White House decisions in relation to tariffs and retaliatory action from the Chinese.

Chart of the Month – 12 Month Forward PER & Earnings Growth

We often talk about the 12 month forward PER, and use it as a reference point, to help determine market value. The multiple alone does not indicate value, but rather the combination of the multiple and earnings growth expectations.

There was an aberration in the relationship in 2015, when the earnings decline was not matched by a reduction in the forward 12 month PER. This occurred, as the decline was very much isolated to the materials and energy space, and was significant, with iron ore and oil prices both falling by about 60% between June 2015 and December 2015. The broader market in fact continued to experience solid earnings growth, and as such the earnings decline in materials/energy had a distorting impact on total market growth.

With earnings growth forecast to be around 10% over the coming year, the 12 month forward PER for the ASX Small Ordinaries, at 16.8x, is on the high side, but is assisted to some extent by low interest rates. Nevertheless, at these types of multiples, stock selection is critical, given it is difficult to envisage much in the way of sustainable PER expansion. Typically there are only brief spikes above 17x.



Best & Worst Performers for March 2018

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	Worst	Best	Worst
Scottish Pacific (SCO)	Appen Ltd (APX)	Bravura Solutions (BVS)	Retail Food Group (RFG)
Webster Ltd (WBA)	Afterpay Touch (APT)	Accent Group (AX1)	Beadell Resources Ltd (BDR)
Global Geoscience (GSC)	New Century Resources (NCZ)	Perseus Mining (PRU)	NRW Holdings (NRW)

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

Scottish Pacific (SCO) – up 9.2% for the month

Following the release of its half year result, on the last day of February, the stock staged a moderate recovery. This recovery was in part due to high single digit EBIT growth for FY18 being reaffirmed.

Bravura (BVS) – up 25.9% for the month (Not Held)

A solid result in February was followed up by the sell down of the last remaining stock overhang, held by private equity firm Ironbridge Capital. Penetration of its Sonata Wealth Management platform continues to gain traction and is expected to drive ongoing growth.

Appen (APX) – down 14.4% for the month

No new news in the month, but after rising close to 300% over the past 12 months, on the back of multiple upgrades and a value adding acquisition, Appen's share price consolidated through the month.

Retail Food Group (RFG) – down 54.4% for the month (Not held)

RFG is in a world of pain. Essentially a broken franchise model, where there is no trust between franchisee and the franchisor (RFG). Significant media exposure has outlined many instances of franchisee hardship, and along with RFG's debt burden, a function of several recent acquisitions, there is some concern as to whether RFG can survive in its current form.

Due Diligence – A closer look at a stock of interest

Webster Ltd (WBA) – An Expanding Agriculture Business

Webster Ltd is a food agribusiness, with interests in production and processing across two segments, Agriculture and Horticulture. Its Agriculture segment includes row crops: cotton, wheat and maize, and also includes livestock interests, in particular organic dorper sheep farming. Its Horticulture segment produces walnuts and more recently almond production. Along with its agriculture and horticulture operations, Webster owns a large portfolio of water rights, which helps to provide a degree of security for both of its operating divisions.

Webster owns land assets across the northern and southern Murray Darling Basin, comprising over 400,000 hectares. The cropping portfolio consists of holdings across the Gwydir Valley, Bourke, Menindee, Riverina and Hay districts. Walnut operations are located in the Riverina district of NSW, at Leeton and Tabbita, and also in Tasmania. In March 2018 Webster announced the acquisition of the Sandy Valley almond property, located close to Webster's walnut operations in Tabbita. The acquisition includes 260 hectares of 2 and 3 year old trees, with the potential for further planting of 460 hectares.

Webster's water interests are a strategic asset. In total, it owns over 200,000 megalitres of annual (temporary) water entitlements, encompassing both high security and general security water. The latter being accessible subject to availability, and after supply of high security water has been allocated. Webster requires high security water for its permanent horticulture crops. General security water is typically used for annual row cropping. Webster has 40,000 hectares of irrigable land within its Agriculture division.

Webster has the flexibility to use its annual water entitlements in the production of its row crops, or to sell its allocations to third parties, where it either has excess requirements, or it becomes more profitable to sell water rather than applying it to its own irrigable land.

Webster is an asset rich business, with a stated book value at last balance date, September 2017, of \$1.34. However this includes water rights at \$212m. At current market prices for permanent water, Webster's water portfolio is likely to be worth in the vicinity of \$300m. This would place Webster's book value around \$1.58/share.

