JM Financial Group

Issue 46: February 2019

Small Companies Strategy – Investment Newsletter

Performance *(As at 28th February 2019)*	**Month (%)**	**Rolling 3mths (%)**	**Rolling 1yr (%)**	**Rolling 3yrs (%)**	**Inception (%)**
JMFG Small Companies Strategy	**+4.24**	**+2.06**	**-2.03**	**+41.60**	**+92.2**
Small Ords Accumulation Index	+6.78	+8.01	+3.48	+45.98	+49.5
Outperformance	**-2.54**	**-5.95**	**-5.51**	**-4.38**	**+42.7**

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) and taxes. Strategy Inception for Performance Data is July 1st 2014.

***Month in Review –** A review of events that influenced the share market and portfolio in February*

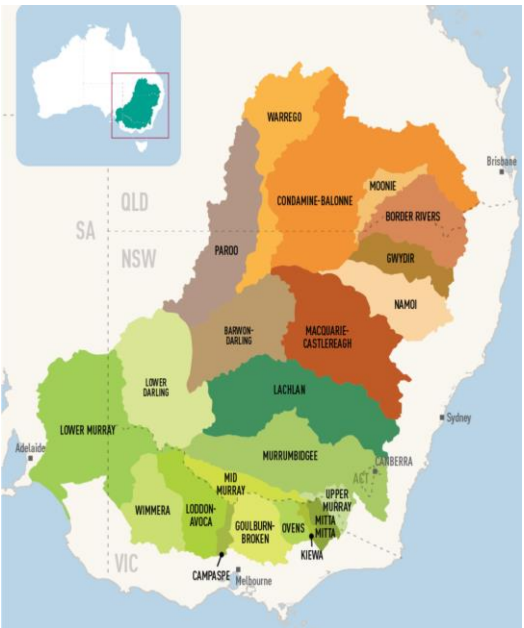
The ASX Small Ordinaries Accumulation Index rallied 6.78% in February against the JMFG strategy which increased 4.24% for the month. The JMFG Small Companies Strategy performed poorly in January due to a c14% cash holding in a rising market, and what we believe was an unwarranted fall in The Citadel Group based on weaker revenue growth. In our view, this was simply a function of shifting to a software as a service (SaaS) model, where monthly payments are made, and away from a managed service model where revenue is paid as service is provided. Following the continuation of the rally in February, the market has retraced all it had lost through to mid-December and is on the expensive side again.

The ASX Small Ords 12-month forward PER, as per *Factset* consensus data, increased from 16.8x at the end of January to 18.0x at the end of February, up 7.1%, broadly in line with the index change, hence net earnings changes through the month appear to have been minimal. Having said that, companies that disappointed were treated harshly, whilst there were some notable rises and falls across most sectors.

The ASX Small Industrials rallied 7.1% along with the ASX Small Resources which increased 5.8%. Strongest sectors during the month included Financials +9.1%, Energy +7.9%, I.T. +7.6% and Consumer Discretionary +6.6%. Weakest sectors included Consumer staples -1.5%, Healthcare +1.0% and Property +1.8%.

The portfolio's better performing stocks in the month included Appen +47%, Breville Group +43%, Sensen Networks +33%, Infomedia +25% and Nearmap +23%. The worst performers included The Citadel Group -20%, SRG Global -19% and Mayne Pharma -13%. The portfolio was actively traded during the month, around significant result-related price swings. We added Breville Group and Infomedia ahead of strong results, and we diversified our gold exposure reducing St Barbara at month-high prices and adding Saracen Gold. We removed Lovisa and Corporate Travel on price strength and cut the last of our holdings in Hub24.

Chart/Table of the Month – Australia's Food Bowl



The Murray-Darling Basin is Australia's major food bowl. Like any food bowl it is highly dependent on rainfall and water storage levels. When rainfall is low, water storage provides a buffer that helps to smooth annual production levels. According to ABARE Australia's farm production for 2018/19 is likely to be 4% lower at $58b, largely due to poor winter crops in eastern Australia. Higher prices and near-record crops in Western Australia provided a significant buffer. Production in eastern Australia has been severely impacted by drought and more lately by the Queensland floods.

Without good rain across NSW and Victoria this coming autumn/winter, production may not rebound – given Murray-Darling Basin water storage levels are currently around one third full. This compares with storage in excess of 50% full 12 months ago and two thirds full 24 months ago. Winter crops (wheat) typically rely on rainfall but many summer crops (rice, cotton) rely on irrigation.

To put this in perspective, Murray Irrigation covers irrigation areas along the northern side of the Murray, from Mulwala to Moulamein. In FY16/17 100% of general security annual water entitlements were allocated. In FY17/18 only around 50% of annual entitlements were allocated, and in FY18/19 there were no allocations. General Security water is used for annual crops; and allocation history is volatile – General Security water is only allocated after High Security water allocations can be met. High Security water is typically used for orchards, where specified minimum levels of water are required for plant survival.

Best & Worst Performers for February 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Appen – APX	The Citadel Group – CGL	BWX – BWX	Blackmores – BKL
Lovisa Holdings – LOV	SRG Global – SRG	Automotive Holdings – AHG	Pact Group Holdings – PCT
Sensen Networks – SNS	Mayne Pharma – MYX	Appen - APX	Saracen Mineral Hldgs - SAR

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

Appen (APX) – up 46.7% for the month

Appen reported its 2018 results with underlying net profit after tax increasing 148% to $49.0m. In addition, it forecast EBITDA for 2019 of $85-$90m at a US$/A$ exchange rate of 74c – for 2018, Appen reported EBITDA of $71m.

BWX (BWX) – up 53.9% for the month (Not held)

Having fallen from $8 to $1.50 since early 2018, a bounce was, at some stage, inevitable. The company reported underlying net profit after tax of $4.0m, down from $10.8m in its first half FY18 result, and FY19 EBITDA guidance was moderated to $27-$29m, from $27-$32m.

The Citadel Group (CGL) – down 19.9% for the month

The market was disappointed with revenue growth of 5.5% and EBITDA growth of 3.2% for 1H19. Much of this lower growth is a reflection of a shift to an annuity pricing model, away from a managed service model with larger upfront/establishment costs. We believe the market has over-reacted and Citadel will rebound over time.

Blackmores (BKL) – down 27.7% for the month (Not held)

The market was disappointed with revenue growth in 1H19 of 11%, which only translated into 2% growth in earnings before interest and tax, and nil growth in net profit after tax. The CEO also announced his resignation.

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

Infomedia (IFM)

Infomedia is a global leader in parts and servicing software for motor vehicles. It has over 170,000 users across 186 countries and 29 languages. Essentially, this is a business that has helped the auto repair and service industry transition from a clunky hard-copy based model to an efficient cloud-based model. Its electronic parts catalog updates the latest OEM parts data and helps dealers increase sales of OEM equipment to repair and body shops, and connects the entire parts sales channel from OEM to dealer and wholesale customer.

It also provides the car service industry with an industry-leading software platform to improve service productivity, as well as providing a precision service-quoting platform, and digital vehicle inspection, through a plug-in diagnostic, that enables service staff to identify and price any additional repair work required to ensure a full health assessment of a motor vehicle. As an adjunct to the business, Infomedia also provides data analysis and information research back to the automotive and lubricant industries and thus provides a loop from the manufacturer, to dealer, service provider, and end-customer.

The company continues to invest in innovation to deliver best of breed, high-performance cloud software for dealerships around the world, providing real-time information, accessible wherever and whenever required.