JM Financial Group

Issue 45: January 2019

Small Companies Strategy – Investment Newsletter

Performance (As at 31st January 2019)	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**+3.54**	**-3.20**	**-6.68**	**+28.61**	**+84.34**
Small Ords Accumulation Index	+5.56	+0.78	-3.06	+38.01	+40.01
Outperformance	**-2.02**	**-3.98**	**-3.62**	**-9.40**	**+44.33**

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.

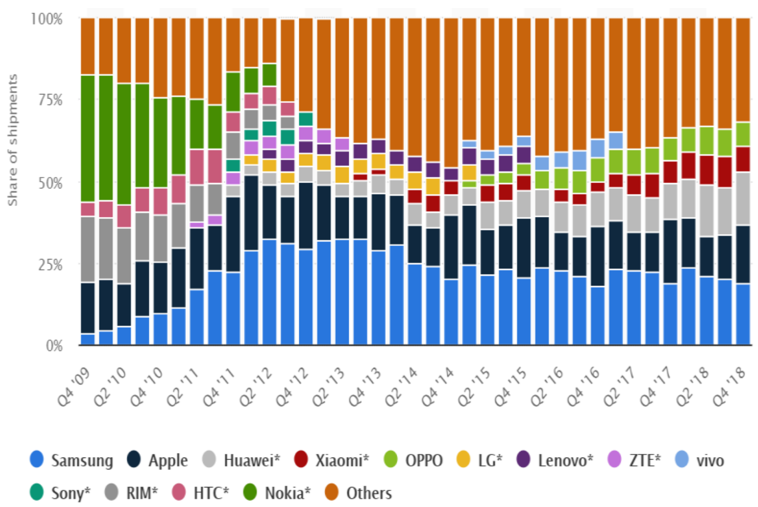
***Month in Review** – A review of events that influenced the share market and portfolio in January*

The ASX Small Ordinaries Accumulation Index rallied 5.56% in January against the JMFG strategy which increased 3.54% for the month. The Index increased 0.78% for the quarter, and declined by 3.06% for the year to January 31. The JMFG Small Companies Strategy performed poorly in January due to a c15% cash holding in a rising market, and a number of its smaller capitalisation holdings not participating in the January rally. We are unconvinced the January rally can be sustained – although low interest rates look to be in place for some time longer, there has been a general earnings downgrade bias. For example, while the ASX Small Ords 12-month forward PER, as per *Factset* consensus data, increased from 15.6x at the end of December to 16.8x at the end of January, an increase of 7.7% against the 5.6% rise in the ASX Small Ordinaries, hence suggesting some pull back in forward earnings estimates. *Factset*, a compilation of historic company earnings and broker forecasts, has recorded in the first five weeks of 2018, 83 downward revisions to forecasts in the ASX Small Ordinaries Index of 200 companies, against 60 upward revisions and the balance unchanged.

The small end of the market, having had a poor December relative to the ASX 200 Accum Index, recovered some ground. The ASX Small Resources led the charge in January, rising 8.1% compared with the ASX Small Industrials, which increased 4.8%. Energy stocks were a major driver of the ASX Small Resources, with notable rises including Beach Energy +33%, and New Hope Corporation +18%.

The portfolio's better performing stocks in the month included Opthea +32%, Temple & Webster +26%, Appen +24%, Citadel Group +17%, and Polynovo +13%. While there were some exceptional returns in parts of the portfolio, a number of stocks performed poorly, including Vault Intelligence -17%, Medical Developments -14%, SenSen Networks -12%, and Ioneer -12%. During the month, we added several new stocks including Beach Energy, Costa Group (following price weakness caused by an earnings downgrade), and Nearmap. We also added to Polynovo on price weakness mid-month. We moderated positions in Hub24 at attractive prices, and sold Echo Resources following a capital raising allocation.

Chart/Table of the Month – The Changing World of Mobile



In 2018 Huawei sold over 200 million mobile phones, up from a little over 150 million in 2017. Only Samsung sold more phones in 2018, but Huawei is gaining ground. Apple came in third and the top 3 share of annual phone sales expanded over the course of 2018, mainly due to Huawei's growth.

The chart opposite highlights the massive change in the industry over the past 10 years. In 2009, Nokia was by far the biggest seller of phones, followed by RIM (Blackberry). At this time, Apple was just starting to make significant inroads, following the release of 3G phones in 2008. The initial iPhone was released in 2007.

Digitisation has rapidly increased business life cycles in many industries, and the chart opposite is a perfect example of how rapidly technological change can determine the fortunes of a major company inside a decade. It also highlights the need to always be on the lookout for the next big disruptor, and the incumbents that are likely to suffer from change.

Best & Worst Performers for January 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Opthea – OPT	Vault Intelligence – VLT	Nearmap – NEA	Navigator Global – NGI
Temple & Webster – TPW	Medical Developments – MVP	Integrated Research – IRI	Costa Group Holdings – CGC
Appen – APX	Ioneer – INR	Beach Energy – BPT	Metals X – MLX

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

Opthea (OPT) – up 31.9% for the month

In late January, Opthea was granted a patent in Japan covering its OPT-302 technology, currently in Phase 2b trial. The stock rallied earlier in the month, most likely around expectation of trial results later in the year.

Nearmap (NEA) – up 41.3% for the month (Purchased mid-month)

Nearmap released positive preliminary first half results showing 42% growth in annualised contract value across the group, comprising 107% growth in the US and 23% growth in their more established Australian market. The Strategy purchased Nearmap after these results, gaining around one-third of the rise experienced over the month.

Vault Intelligence (VLT) – down 16.7% for the month

Vault released its quarterly cashflow report late in the month, reporting growth in contracted annual recurring revenue of $511k to $4.23m. While cash receipts were weaker than 1Q we note that they can be lumpy. The company has only recently released Vault Solo, a wearable operational risk management watch with significant revenue potential.

Navigator Global (NGI) – down 28.1% for the month (Not held)
The company reported that outflows and weak investment markets led to Assets Under Management declining 8.8% to US$14.7b.

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

Nearmap (NEA)

Nearmap provides high resolution aerial imagery across Australia, and, more recently it has expanded into the US market. Nearmap updates its aerial imagery up to six times annually, and has developed technology which digitally stitches the imagery together to provide a seamless view. The service provides significant time savings by allowing businesses to inspect and monitor locations via a cloud-based platform. The aerial imagery is combined with a suite of measurement tools that allows visualisation of locations and an ability to analyse work sites and properties for future proposed development by measuring line, area, radius, height, width, and roof pitch and area. The bottom line is that Nearmap is a significant time saver in that it allows site measurement from a remote location.

A subscription provides coverage of urban and regional work sites, including cities and suburbs, covering 454,000 square kilometres annually and 88% of the Australian population. Images are high resolution with each pixel representing no more than 7.5cm actual surface distance. Their cloud-based technology allows the imagery to be viewed from any web-browser capable device and integrates into leading construction applications such as CAD (Computer Aided Design) and GIS (Geographical Information System)

Major customers include government, architecture, construction engineering, telco, transport, utilities, property, insurance, solar, and roofing. The opportunities are significant and Nearmap has first mover advantage in a business where scale will be a requirement.