

Small Companies Strategy – Investment Newsletter

<u>Performance</u> (As at 31 st August 2019)	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	+5.03%	+19.30%	+16.80%	+45.09%	+140.76%
Small Ords Accumulation Index	-3.85%	+1.41%	+0.95%	+27.43%	+55.68%
Outperformance	+8.88%	+17.89%	+15.85%	+17.66%	+85.08%

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.

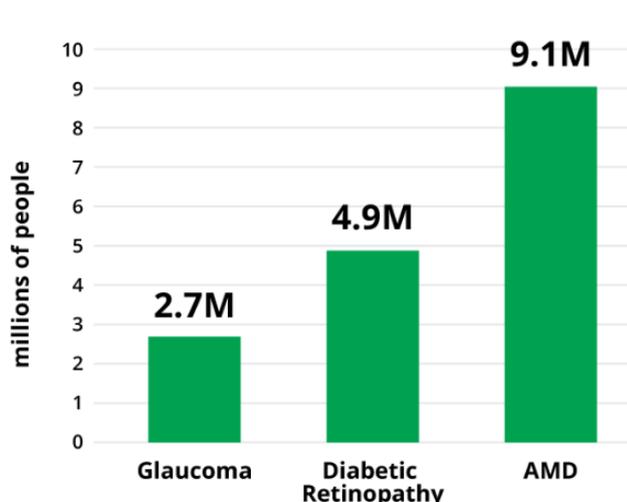
Month in Review – A review of events that influenced the share market and portfolio in August

Despite the ASX Small Ordinaries Accumulation Index declining 3.85% in August, the JMFG Small Companies portfolio posted a positive return of 5.03%, outperforming its benchmark index by 8.88% for the month. The portfolio has had an exceptional quarter, rising 19.30%, against a benchmark rise of 1.41%. Around two thirds of the Strategy's 8.88% outperformance in August came from Opthea, a medical technology company that sat quietly in our portfolio for two and a half years, whilst the company has been undertaking its Phase 2b trial, involving 366 patients globally. The highly successful results of that trial, released early August, propelled the stock through the month and attracted great interest from a number of broking houses and institutions not previously involved with Opthea.

Strongest sectors across the broader market in August included Healthcare +3.6%, Property Trusts +1.2%, I.T. +0.3%, and Consumer Discretionary +0.2%. Weakest sectors included Materials -7.5%, Energy -5.6%, Telecommunications -3.1%, and Financials -2.6%. Our best stocks for the month included: Opthea +341%, Polynovo +27%, Codan +17% and Beach Energy +15%. Weakest stocks included Nearmap -19%, Medical Developments -16%, Appen -16% and Breville Group -15%. The ASX Small Ordinaries continues to trade near all-time high levels at 18.1x the 12-month forward PER, as per Factset consensus data, a 10% premium to the ASX 200 index.

We added one new stock to the portfolio during the month, Infigen, a renewable energy generator, following its FY19 result. We did so at prices beneath book value and only slightly ahead of its net tangible asset backing. We have been looking at investing in Infigen for the past two-plus years, but only recently has its pricing and financial structure been sufficiently attractive enough to do so. We removed two stocks from the portfolio in August, McMillan Shakespeare following its results and off-market buyback announcement, which saw a significant rally in its share price, and Rural Funds Group following a bounce after the initial impact of a short seller report was released to the market. We cut holdings in Beach Energy and Bapcor on share price strength and added to holdings in Appen, Nearmap and Breville Group on share price weakness. The cash holding at month-end was 13.5%, up from 9.9% at the end of July.

Chart/Table of the Month – U.S. Age-Related Macular Degeneration



Source: "Can optometrists help eliminate blindness caused by AMD?" (Maculogix AMD Academy, 2017)

Age-related macular degeneration (AMD) is the leading cause of vision loss and blindness in people over 50 years of age in the developed world. While dry AMD is more common, with 85-90% of people diagnosed with AMD suffering the dry form, the wet form usually leads to more serious vision loss. In 2010, there were an estimated 9.1m cases of early AMD in the U.S. and this is projected to reach close to 18m by 2050. In the developed world there are an estimated 4m+ cases of wet AMD.

Existing patented treatments for wet AMD include both Lucentis and Eylea, with the latter more recently becoming the dominant of the two patented drugs. Eylea, distributed by Regeneron in the U.S. and Bayer in the rest of the world, had sales in 2018 of US\$6.7b. Lucentis, distributed by Roche in the U.S. and Novartis in the rest of the world, had 2018 sales of US\$3.9b.

In addition to Eylea and Lucentis, Avastin is being used *off-label* (not approved for this use) as a wet AMD treatment – it does benefit those suffering from the disease to some extent, so it is used as a cheaper but less effective drug. Avastin is estimated to have 60% market share and is used largely by those unable to afford health insurance.

Best & Worst Performers for August 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	Worst	Best	Worst
Opthea – OPT	Nearmap – NEA	BWX – BWX	Speedcast International – SDA
Polynovo – PNV	Ioneer – INR	ERM Power – EPW	Amaysim Australia – AYS
Infigen Energy – IFN	Medical Developments Int'l – MVP	Dacian Gold – DCN	Liquefied Natural Gas – LNG

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

Opthea (OPT) – up 341% for the month

Opthea released its Phase 2b trial for wet-AMD (Age-related Macular Degeneration), a disease causing the growth of blood vessels behind the macula (central portion of the retina) and the leading cause of blindness in the developed world in individuals aged over 50. The Phase 2B results were exceptional with an improvement of 14.2 letters of vision from baseline, compared to 10.8 letters in the control group.

BWX (BWX) – up 50% for the month (Not held)

BWX reported a good second-half result with US retail sales 19.5% higher than first half sales and overall underlying EBITDA improved by 100%. In addition, there was a substantial cash flow improvement which saw net debt decline by \$8m to \$56m from December.

Nearmap (NEA) – down 19% for the month

Nearmap reported its FY19 result and while its annual contracted value improved by 36%, broadly in line with expectations, the company announced a higher level of investment to exploit its market-leading advantage and ongoing evaluation of further geographic expansion.

Speedcast (SDA) – down 59% for the month (Not held)

A downgrade to expectations in early July was followed by a disappointing first half result, weak cash flow, growth in net debt to \$620m and departure of executives. Risks are enormous in this company and a restructuring of its balance sheet could see further equity erosion.

Due Diligence – A closer look at a stock of interest

Opthea (OPT)

Opthea is a biological drugs developer focusing on ophthalmic disease therapies. Its OPT-302 drug is a soluble molecule that blocks the activity of two of the Vascular Endothelial Growth Factor proteins, (VEGF-C and D) – overexpression of VEGF causes blood vessels to grow and potentially leak, and presents most prominently at the back of the retina which in turn can lead to permanent blindness. OPT-302 is used in combination with other drugs (namely Lucentis, which inhibits VEGF-A, and Eylea, which covers VEGF-A and B) to achieve a more comprehensive blockade against the proteins in the VEGF family. The combined treatment has potential to improve vision outcomes by completely inhibiting the pathways in disease progression. OPT-302 may also have applications in treating Diabetic Macular Oedema (DMO), with Phase 1b/2a trials ongoing.

Opthea's Phase 1/2a wet AMD trial results in April 2017 encouraged our initial investment in the company. This trial involved 51 patients with results suggesting improved outcomes across a range of patient groups. The Phase 2b study involved 366 patients split into a group that only received the existing standard of care, a group that received the existing standard of care plus a small-dose (0.5mg) regimen of OPT-302, and a group that received the existing standard of care and a larger dose (2.0mg) of OPT-302. This latter group achieved an average 14.2 letter gain on eye chart tests, compared with 10.8 for those receiving only the current standard of care. These results are seen as significant in the ophthalmology industry, although OPT-302 is still subject to larger Phase 3 trials. Nevertheless, the strength of the results, and the current size of the market at \$10b and growing, places Opthea in an attractive position, particularly given the incumbents have much to lose as their drug technologies come off patent in the early part of the next decade.

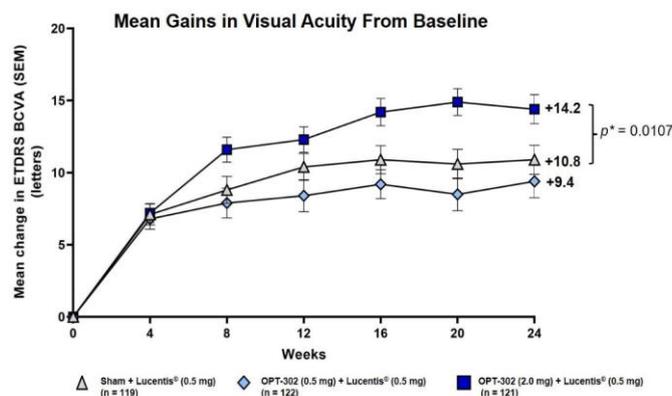


Figure 1. OPT-302-1002 clinical trial (NCT03345082). Graph represents observed data and standard error of the mean (SEM). Modified Intent-to-treat study population. BCVA, Best Corrected Visual Acuity; ETDRS, Early Treatment Diabetic Retinopathy Study. * Difference in Least Square Means, using Model for Repeated Measures (MRM) analysis. Control of Type I error via the Hochberg Procedure.

VEGF-A Inhibitors



Market Opportunity

>\$10BN
Worldwide

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