Issue 53: September 2019

Small Companies Strategy – Investment Newsletter

Performance *(As at 30th September 2019)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**+0.32%**	**+14.48%**	**+17.83%**	**+41.77%**	**+141.55%**
Small Ords Accumulation Index	+2.61%	+3.11%	+3.95%	+28.79%	+59.74%
Outperformance	**-2.29%**	**+11.37%**	**+13.88%**	**+12.98%**	**+81.81%**

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.

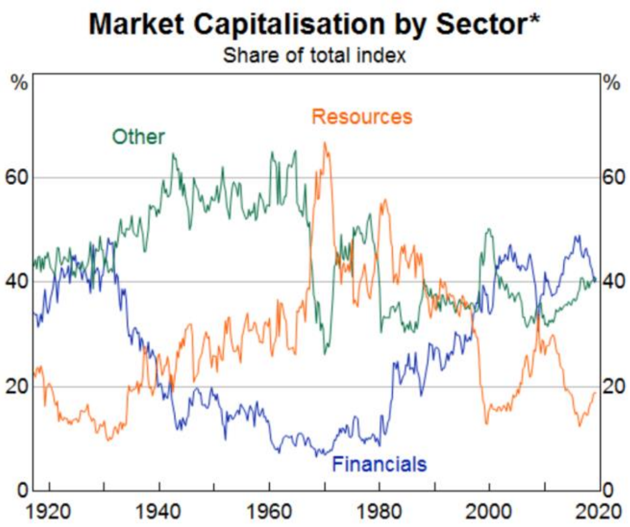
***Month in Review –** A review of events that influenced the share market and portfolio in September*

After three strong months of both absolute and relative performance, the JMFG Small Companies Strategy had a flat month, in absolute terms, and underperformed its benchmark index by 2.29% in September. The Strategy is up 35.7% Calendar year to date and by 17.8% over a rolling 12-month period, with outperformance against the benchmark for each of these periods in the order of 14-15%. Around 80% of the Strategy's underperformance in September came from Mach7, a medical technology software company that has generated significant outperformance for the portfolio over the calendar year.

Strongest sectors across the broader market in September included Energy +4.7%, Financials +4.1%, Consumer Discretionary +3.0%, and Materials +3.0%. Weakest sectors included Telecommunications -3.0%, Property Trusts -2.7%, and Health Care -2.5%. Our best stocks for the month included SelfWealth +77%, Temple & Webster +20%, Netwealth +19%, Codan +17%, and Infigen Energy +15%. Weakest stocks included Appen -18%, Mach7 Technologies -15%, Bravura Solutions -15%, and Resolute Mining -15%. Following the rebound in the Financials Sector, its total return over the past 12 months is right in line with the ASX200 index. The Financials Sector's recent good performance is likely a result of an improving housing market, with residential clearance rates rising to above 70% in both Sydney and Melbourne, reports of loan applications levels soaring, and quarterly house prices increasing for the first time in over 18 months.

We added one new stock to the portfolio during the month, PKS Holdings, a health care software technology business operating in the pathology space. PKS Holdings is an established profitable operator but has potential to grow its earnings base under new management, which has begun scaling up its sales and marketing effort. While no stocks were removed from the portfolio during September, we trimmed our position in Codan, after six months of very strong performance. We also added weight across ten existing holdings as part of a strategy to reduce our cash position, following profit taking across several stocks over the past six weeks. The cash holding at month-end was 9.6%, down from 13.5% at the end of August.

Chart/Table of the Month – 100-Year Market Sector Trend



* Largest 100 companies by market capitalisation prior to 1979; Refinitiv Datastream calculated series for whole exchange from 1980

Sources: ASX; RBA; Refinitiv Datastream

The chart opposite highlights the changing mix of the Australian share market over the last 100 years. It highlights the rise of Australia as a resources nation, from the early 1930s through to the 1970s including the Poseidon bubble in the late 1960s, triggered by Poseidon Nickel, but a bubble that saw many mining shares spike.

From the early 1980s, and broadly coinciding with the deregulation of the Australian financial system, and later the introduction of compulsory superannuation, the Financials Sector has grown rapidly to now represent around 40% of the Australian market. Growth in the Australian Financials Sector has come at the expense of the Resources Sector.

The combination of remaining sectors comprises the 'Other' category in the chart. This has accounted for 30-50% of the Australian market over the past 50 years. Over the last decade, 'Other' has climbed from the low 30% level back to 40% representation. The increase in 'Other' has not been a function of volatility within the Resources or Financials sectors over the past decade, but from meaningful growth in Health Care, Information Technology and Infrastructure, thereby broadening the Australian listed base.

Best & Worst Performers for September 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
SelfWealth – SWF	Appen – APX	Bellamy's Australia – BAL	Amaysim – AYS
Temple & Webster – TPW	Mach7 Technologies – M7T	Speedcast International – SDA	ARQ Group – ARQ
Netwealth Group – NWL	Bravura Solutions – BVS	Mesoblast – MSB	OM Holdings – OMH

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

SelfWealth (SFW) – up 77% for the month

On the last business day in August, SelfWealth released their annual report and investor presentation, which highlighted that quarterly trade volumes for the first two months had exceeded their quarterly record. In addition, the company announced their adviser platform had launched and the ETF application was expected to launch in Q1.

Bellamy's Australia (BAL) – up 74% for the month (Not held)

Bellamy's announced it had entered into a scheme implementation deed under which China Mengniu Dairy Company will acquire 100% of the company's issued capital for $13.25/share, comprising $12.65 and a $0.60 fully franked dividend.

Appen (APX) – down 18% for the month

Following its result release in late August, Appen has come under share price pressure with some disappointment around the performance of its recent $280m acquisition, Figure Eight. This has occurred despite its remaining operations reporting an upgrade.

Amaysim (AYS) – down 37% for the month (Not held)

Late August, Amaysim reported net profit after tax of $6.8m for FY19 versus $19.7m in FY18. In addition, its conversion of reported operating earnings to operating cashflow was a disappointing 53%. Over the past two months, the stock has fallen from $0.80 to $0.30.

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

Infigen Energy (IFN)

Infigen owns and operates renewable energy assets. It currently operates three wind farms at Lake Bonney in S.A. with 278.5MW capacity and a battery storage facility. In W.A. near Geraldton, it has an 89MW wind facility, and in NSW it has an 113MW facility at Wellington and 189MW of capacity north-west of Canberra at two locations. Infigen has a further 8 wind farms either planned or under development that could deliver in excess of 800MW of additional capacity. In addition to its wind assets, Infigen has two solar farms in development in NSW, with total capacity of 62MW and a further 3 solar farms in the pipeline that could deliver up to 185MW of additional capacity.

While Infigen has many development plans in the pipeline, it does carry a large debt level on its balance sheet that will limit the number of assets able to be developed at any one time. It also recently began paying distributions and will most likely keep paying distributions in the immediate future, thereby limiting the rate of development. In FY19, Infigen generated $156m in earnings before interest, tax, depreciation and amortisation (EBITDA). This compares to its year-end net debt of $532m. Whilst it is not uncommon for infrastructure assets to have relatively high gearing, we expect the focus of the company will be to reduce the ratio of net debt to EBITDA, maintain a level of dividends and manage growth in the asset base prudently. The JMFG Small Companies Strategy recently acquired Infigen at prices at a 10-15% discount to book value, and at a minor premium to its net tangible asset value.

Wind Energy Assets