JM Financial Group

Issue 54: October 2019

Small Companies Strategy – Investment Newsletter

Performance (As at 31st October 2019)	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**+2.96**	**+8.50**	**+30.61**	**+48.84**	**+148.72**
Small Ords Accumulation Index	-0.50	-1.84	+14.41	+34.48	+58.94
Outperformance	**+3.46**	**+10.34**	**+16.20**	**+14.36**	**+89.78**

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 management fees paid (post 1 Jan 17), taxes and indicative accrual of performance fees. Strategy Inception for Performance Data is July 1st, 2014.

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

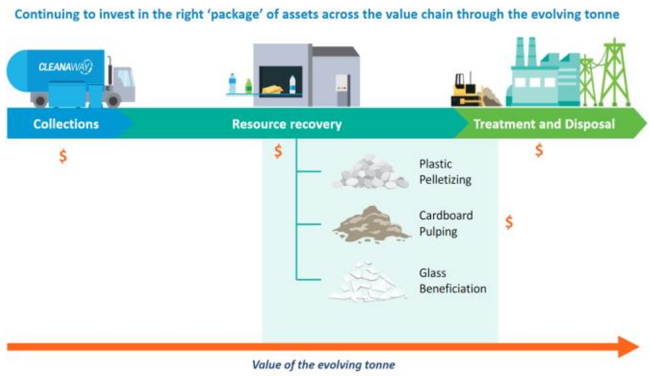
The JMFG Small Companies Strategy had a solid month, rising 2.96% compared to its benchmark, the ASX Small Ordinaries Accumulation Index, which declined by 0.50%, thereby outperforming by 3.46%. The Strategy is up 30.61% over the rolling 12-month period compared to its benchmark at 14.41%. The Strategy has now had two successive years of solid returns. While return volatility will always exist, our aim is to moderate volatility by investing in a selection of innovative businesses that are able to grow revenues and earnings regardless of economic or market conditions. These stocks sit alongside a core of more advanced small companies that continue to have above average growth prospects. On a combined basis, this provides excess return potential whilst moderating portfolio volatility.

Strongest sectors across the broader market in October included Health Care +7.6%, Industrials +3.0%, Utilities +1.4%, and Property Trusts +1.2%. Weakest sectors included I.T. -3.9%, Materials -2.9%, Financials -2.8%, and Consumer Staples -2.2%. Our best stocks for the month included Webster Ltd +56%, Temple & Webster +21%, Medical Developments +16%, and Imdex +14%. Weakest stocks included SelfWealth -20%, Resolute Mining -15% and Sensen Networks -13%.

We added one new stock to the portfolio during the month, New Century Resources, following improved operating metrics, with zinc recoveries averaging 48% through the September quarter and averaging 52% in the month of September. This compares to 44% average recovery in the June quarter. Implementation and commissioning of the full cleaner circuit in mid-August led to the recovery improvement. The improved recoveries saw cash costs decline to US$0.99/lb in the September quarter and US$0.90/lb for the month of September. The improved operating metrics also coincided with a 12% rise in the spot zinc price to US$1.15/lb over the quarter, along with a substantial fall in the share price over the calendar year; we now assess the risk/reward to be favourable. We removed Bapcor from the portfolio following a solid rally over the past few months and lightened holdings in Mach7, Polynovo, SelfWealth, and Codan each following solid share price improvements. The cash holding at month-end was unchanged at 13%.

Infographic of the Month – Closing the Loop on Waste

Waste is a global issue that has had greater prominence in Australia over the past 12 months. Factors leading to this regrettable situation include; rejection of Australia's waste by China, fires of toxic waste materials stored both in warehouses and yards, and waste companies going into administration leaving collection, storage, separation and recycling of waste a major issue for local councils. A range of proposals and trials are currently in place to deal with the issues, but all outcomes are likely to have some adverse cost impact on households. With the appointment of receivers to SKM Recycling, the concept of actually paying councils to collect recycling materials is now defunct. All future contracts should involve all councils paying to have recycling material collected. A small number of councils in Melbourne are about to start trialing additional bins for separate glass, plastics and cardboard collection. The plan also includes all organic waste going into a single bin.



The ultimate closed loop solution requires treatment facilities where remaining waste, unable to be recycled, can be converted into energy production. Environmental processing of the smoke stack has apparently advanced such that little or no gas materials are released into the atmosphere. A component of the small amount of end hard waste (flyash) has some potential to be used in road surfaces. Any residual hard waste to be deposited into landfill is reported to be a very small fraction of the original volume. Any closed loop system in Australia may still be some time off as the costs to build plants to fully deal with household waste across a city the size of Melbourne or Sydney is likely to be in the billions. In addition any appropriate return potential may require government assistance. Nevertheless, such a solution is ultimately necessary.

Best & Worst Performers for October 2019swf-auays-au

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Webster – WBA	SelfWealth – SWF	New Century Resources – NCZ	Southern Cross Media – SXL
New Century Resources – NCZ	Resolute Mining – RSG	Sealink Travel Group – SLK	Sundance Energy – SEA
Temple & Webster – TPW	Sensen Networks – SNS	Class – CL1	Navigator Global – NGI

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

Webster (WBA) – up 56% for the month

Webster announced that it had entered into a binding Scheme Implementation Agreement with a wholly owned subsidiary of Public Sector Pension Investment Board, a Canadian Pension Fund, for a cash price of $2.00/share, by way of a court approved scheme of arrangement.

Sealink Travel Group (SLK) – up 41% for the month (Not held)

Sealink announced the 100% acquisition of Transit Systems Group and $150m capital raise. The transaction is expected to be 20% accretive. The purchase price is A$635m (cash and scrip) plus up to A$63m earnout – Transit Systems management takes effective control.

SelfWealth (SFW) – down 20% for the month

Having more than doubled over a five-week period from late August through to the end of September to 28c, the stock eased through October on no significant news. It did release its quarterly report which continued to show improving metrics across all categories.

Southern Cross Media (SXL) – down 34% for the month (Not held)

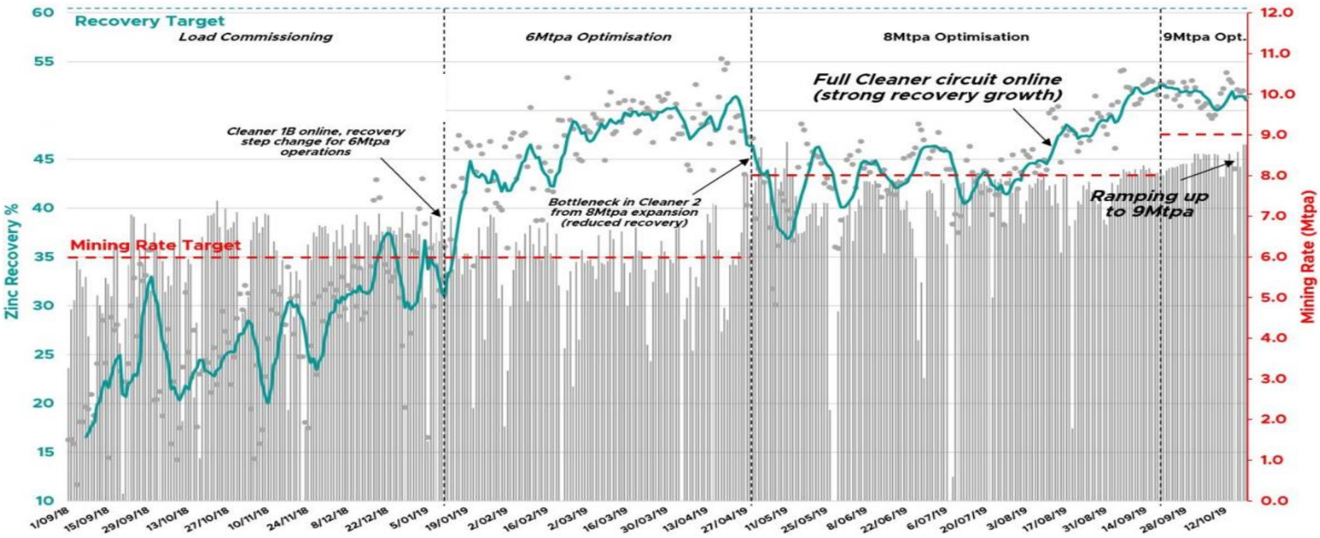
Southern Cross Media announced a trading update, stating that revenues in the first quarter of FY20 were 8.5% lower than the prior year, with declines experienced in both the audio and television segments. Management also confirmed that the general advertising market remained short and volatile, a concern leading into the seasonally stronger Christmas quarter.

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

New Century Resources (NCZ)

New Century Resources (NCZ) is a stock that we have followed for over two years and was previously held in the Small Company Strategy through FY18. NCZ has been a high-risk play, given it is essentially a tailings treatment operation – tailings being the waste or by-product from ore that has been previously processed. The stock performed for us when it was previously held, but ultimately the risks became too great and we sold for a good profit. Since then, the company has moved into commissioning phase, facing several difficulties through that process. Over the same period, the stock has lost around 70% of its value. Only in the most recent quarter has commissioning begun to show real progress, following the full cleaner circuit being brought online.

Zinc recoveries averaged 48% in the September quarter and 52% in the month of September, a significant improvement on prior quarters. At the same time, production costs have declined. Based on the potential annual cash earnings capacity relative to its market capitalisation, the risk/reward on NCZ once again looks attractive, hence its re-introduction into the portfolio. Whilst many factors will have a major bearing on the ultimate annual cash generation of the operation, not the least being zinc prices and zinc concentrate treatment charges, it is possible that New Century's annual potential cash earnings will equal its current market capitalisation.



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