JM Financial Group

Issue 56: December 2019

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st December 2019)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**+0.70**	**+3.77**	**+38.85**	**+56.06**	**+149.47**
Small Ords Accumulation Index	-0.29	+0.76	+21.36	+33.03	+60.96
Outperformance	**+0.99**	**+3.01**	**+17.49**	**+23.03**	**+88.51**

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 2.9% est. 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 December*

The JMFG Small Companies Strategy increased 0.7% in December, outperforming its benchmark, the ASX Small Ordinaries Accumulation Index, by 0.99% for the month, following a decline in the benchmark of 0.29%. The Strategy is up 38.85% over the rolling 12-month period, compared to its benchmark at 21.36%, and its rolling three-year performance is up by c56%, compared with its benchmark c33%.

While the ASX Small Ords Accum declined 0.29% in December, it did fare substantially better than the ASX 200 Accumulation Index, which declined by 2.17% for the month. The best performing market segments were Materials +1.55% and Utilities +0.78%, the only positive total return sectors for the month of December. Weakest sectors included Consumer Staples -8.05%, Telecommunications -5.8%, Information Technology -4.6% and Property Trusts -4.41%. Our best stocks for the month included Medical Developments +28%, Temple & Webster +25%, Codan +13% and SenSen Networks +11%. Weakest stocks included SelfWealth -14%, Nearmap, Imdex and PKS Holdings, all of which declined by 9%.

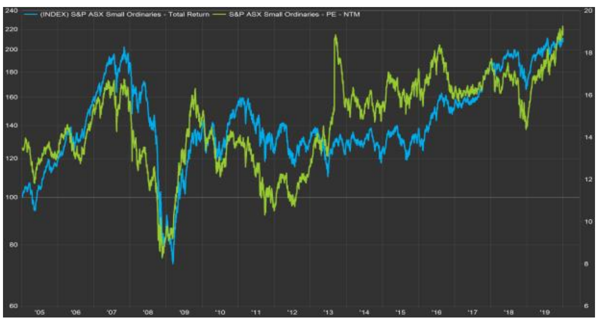
We added one new holding to the portfolio during the month, Pro Medicus, following a sustained price decline since August 2019 and the share price falling in the vicinity of 40% from its peak. Pro Medicus owns the premier global radiology imaging technology and is experiencing rapid revenue and earnings growth, the latter in part due to the very high operational leverage the company enjoys, reflecting its fixed cost base.

Net cash holdings in the portfolio at month-end reduced from 11.1% to 10.1%. Our purchase of Pro Medicus was funded by reducing our holdings across several stocks, all of which had experienced recent price strength. In particular, we reduced holdings in other health-related investments including, Mach7 Technologies, PolyNovo, Medical Developments, and Opthea. We also reduced holdings in Webster as the stock neared the proposed Scheme offer price of $2.00 per share, and Imdex on price strength.

Chart of the Month – ASX Small Ordinaries & Value – Can the run continue?

The chart below is a comparison between the ASX Small Ordinaries Index on a total return basis (left-hand side) and the 12-month forecast Price to Earnings Ratio (PER) of the same Index (right-hand side). The total return is indexed to a starting point of 100 and is shown on a logarithmic scale, to ensure similar percentage points movements over time are more easily compared. Since the end of 2004, the ASX Small Ordinaries Index on a total return basis (all dividends reinvested) has more than doubled, but the GFC caused a major disruption in the process. The Index more than halved during the tumultuous GFC period, recovered somewhat through 2009 and then largely tracked sideways through to the end of 2015. With the exclusion of 2018, the Index has been on a tear since the end of 2015. It looked expensive at the end of 2016 and kept going before moderating in 2018. So, can the run continue?

It is not a question we like to answer on a short-term basis. There are so many factors at play, from the micro through to the macro. All of these factors combine together to determine the outcome of equity markets the world over, and of specific indices or stocks within those markets. We have no special skill in assessing all those factors, but we do know that, over time, the ASX Small Ordinaries should



generate solid returns, and if we do our job well in selecting stocks, we should outperform the index. Within the normal expectations of volatility that is something we have done relatively consistently over the five and a half years since inception. The ASX Small Ordinaries is far more diverse today than it ever has been with significant broadening of higher growth segments of Health Care and I.T. This, in part, explains the growth in the 12-month forward PER of the Index to all time high levels, and it also provides far greater long-term growth potential for the Index going forward. So, while it looks expensive today, the composition of the Index makes it a very different beast.

Best & Worst Performers for December 2019

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Medical Developments – MVP	SelfWealth – SWF	Syrah Resources – SYR	Metals X – MLX
Temple & Webster – TPW	Nearmap – NEA	Perseus Mining – PRU	AMA Group – AMA
Codan – CDA	Imdex – IMD	IMF Bentham – IMF	Jumbo Interactive – JIN

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

Medical Developments (MVP) – up 28% for the month

MVP received marketing authorisation approval in Russia for its core product Penthrox in December. The only other relevant news for the month was an announcement of a new major shareholder on the register. The stock has now increased by over 70% over the final quarter of the calendar year.

Syrah Resources (SYR) – up 34% for the month (Not held)

With no new news during December, the rally in Syrah Resources may be nothing more than a relief rally, having lost over 90% of its market capitalisation over the two-year period to the end of November 2019.

SelfWealth (SWF) – down 14% for the month

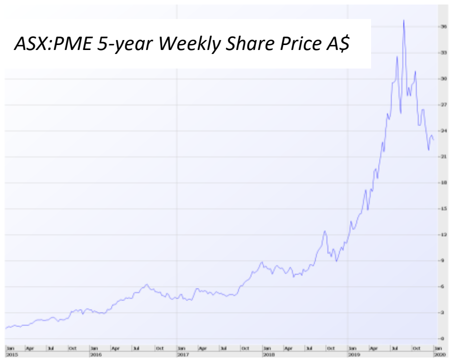
SelfWealth's share price has continued to drift lower over the past three consecutive months, since peaking at the end of September 2019. It may need another strong set of metrics in the upcoming 4C at the end of January to reverse this trend.

Metals X (MLX) – down 31% for the month (Not held)

Bad news and disappointment continued for Metals X. Following the previous suspension of the Nifty mine, the company announced lower than expected tin production from its Renison mine in Tasmania.

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

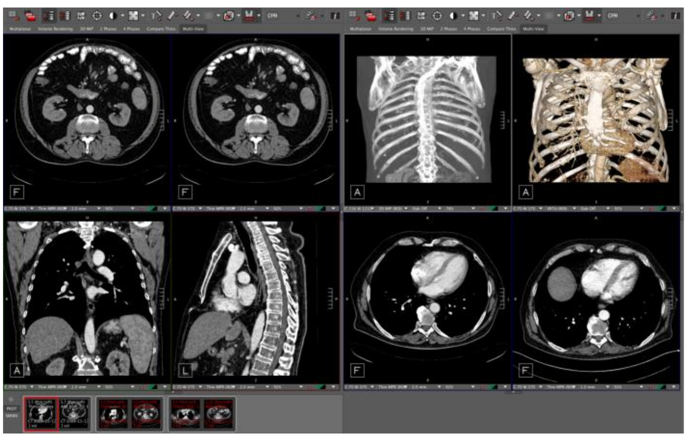
Pro Medicus (PME)



In the company's own words, Pro Medicus [ASX:PME] is a leading health imaging IT provider. Founded in 1983, the company provides a comprehensive range of health imaging software and services to hospitals, imaging centres and healthcare groups. These solutions are branded "Visage" and provide one of the most comprehensive, enterprise level, end-to-end offerings available in the radiology market today. The Visage product line comprises solutions for RIS (Radiology Information Systems) / Practice Management, Healthcare Imaging and e-health. These systems can be used either individually or in combination by radiologists and other medical imaging professionals to interpret the images created by medical imaging equipment such as X-Ray and Ultrasound machines and CT and MRI Scanners, and communicate the results to their referring clinicians.

Pro Medicus posted revenues of A$50.1m for FY19, a 48% rise on the previous year, and net profit after tax was A$19.1m, a rise of 92% on the previous year. With EPS of 18.5c, growing from 9.7c FY18, the company is trading on PER multiples well in excess of 100x, and will have to continue to repeat growth in similar proportion to warrant such optimistic valuation.

Example of Visage's advanced radiology visualisation capability



The company reported significant profit growth increases in all geographical segments, particularly in Europe and North American markets, where it considers itself to be only beginning to make strong inroads, highlighting that there remains significant opportunity and demand for further growth in those markets.

While Pro Medicus remains committed to ongoing research and development to improve and diversify its offerings to fit unmet needs, at this stage of its commercialisation costs are more about cementing its competitive moat – a "best-in-class" reputation. Hospitals and imaging centres that have taken up Visage are spreading positive word of mouth into their associated healthcare networks, and Visage has quickly set the benchmark standard for how image data, archiving and practice management integration is done.