JM Financial Group

Issue 58: February 2020

Small Companies Strategy – Investment Newsletter

Performance *(As at 29th February 2020)*	Month (%)	Rolling 3mths (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception (%)
JMFG Small Companies Strategy	**-10.52**	**-7.05**	**+20.26**	**+43.98**	**+131.94**
Small Ords Accumulation Index	-8.68	-5.87	+1.72	+26.43	+51.95
Outperformance	**-1.84**	**-1.18**	**+18.54**	**+17.55**	**+79.99**

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 0.45% 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 February*

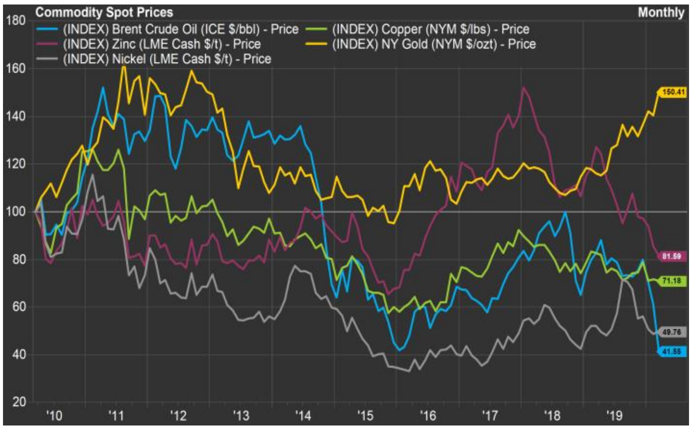
Amidst COVID-19 fears, global financial markets began to melt down in the latter part of February, with falls continuing into March. The JMFG Small Companies Strategy declined 10.52% in February but remains 20.26% ahead over the rolling 12-month period. On a relative basis the Strategy underperformed its benchmark by 1.84% in February but remains ahead of its benchmark by 18.54% over the rolling 12-month period.

While the ASX Small Ords Accum. fell 8.68% in February, the ASX 200 Accum. Index fell by 7.69% – a full 1% less. This is not surprising, given the small end of the market typically has greater volatility in major market swings. No sector was spared in February although there were substantial differences in the magnitude of falls across sectors. The worst performing market segments included I.T. -17.3%, and Energy -17.2% followed by Materials at -11.7%. The best performing sectors included Utilities -3.6%, Health Care -3.7%, Financials -4.9% and Property Trusts -4.9%. Our best stocks for the month included Temple & Webster +13%, Imdex +7%, Breville Group +4% and Infomedia +3%, with each of these companies reporting solid results for the 6 months ending December 2019. The worst performers included New Century Resources -48%, Wisr -36%, Beach Energy -34% and Altium -23%. Each of these stocks were casualties of COVID-19 with energy and metal prices weaker on fears of declining demand, Wisr was weaker based on higher wholesale funding and potential higher loan defaults, and Altium took a hit along with all higher-priced I.T. companies.

We added two new holdings to the portfolio during the month, Citadel Group and LiveTiles, and we removed two companies, Cleanaway and SelfWealth. We added to holdings in Wisr, Imdex and Polynovo, on price weakness through the month. Resulting in the portfolio cash holding declining from 13.9% to 11.0%. As we write this newsletter, the deepening COVID-19 crisis has continued to play havoc upon financial markets, and with no clear end in sight the impact on economic growth has created a level of fear the markets have not seen in over a decade. Buying opportunities will emerge but, from experience, we know these play out over many months.

Chart of the Month – Changing fortunes of commodities

Indexed Commodity Price Movements – 10 years



In general, US$ industrial commodities have been in decline over the past two years, most having experienced recent peaks in the early to middle parts of 2018. Whilst all the major industrial commodities had been in decline prior to the initial widespread reports of COVID-19 into the Western world in mid-January, in most cases, declines have accelerated since then. Spot zinc has fallen in excess of 20% with spot copper and nickel falling between 10-15%. Over the same time, oil has fallen by a dramatic 45%. Interestingly, all these commodities are lower than where they were 10 years ago; with oil 67% lower, nickel 44% lower, copper 27% lower and zinc 18% lower. With global demand continuing to weaken, it is difficult to see a short-term turnaround for any major industrial commodity.

By contrast, gold, in US$ terms, is 50% higher than its spot price 10 years ago and around 8% higher than when COVID-19 was broadly reported over 6 weeks ago. Many people rubbish gold as an investment on the basis that most of it is not used but rather stored, and it cannot be eaten. However, it is a rare commodity in relation to other industrial commodities and it is becoming increasingly expensive to mine, unlike many of the industrial commodities. Gold is as tangible as a building or a piece of land, but unlike buildings and land it can be easily relocated if needed. To that extent, in a crisis, whilst it might ultimately come down in price along with other assets, it has qualities that few other assets have, which makes it enduringly desirable. We are certainly not capable of forecasting the gold price, but it does have increasing demand through crisis periods – in that regard, it does take a position in our portfolios from time to time.

Best & Worst Performers for February 2020

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Temple & Webster - TPW	New Century Resources - NCZ	IDP Education - IEL	ARQ Group - ARQ
Imdex - IMD	Wisr - WZR	Money3 Corporation - MNY	New Century Resources - NCZ
Breville Group - BRG	Beach Energy - BPT	Fisher & Paykel Health - FPH	FAR - FAR

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

Temple & Webster (TPW) – up 13% for the month. TPW delivered a strong result, reporting sales for 1H20 up 50% and trading for the first six weeks of 2H20 up 55%.

IDP Education (IEL) – up 20% for the month (Not held). IEL also reported a strong result for 1H20 with revenue growth of 25% and operational earnings growing at 49%. Since month-end, however, the stock has given back the 20% increase with fears around the restricted travel movement impact on students affecting demand for English language testing.

New Century Resources (NCZ) – down 48% for the month. Whilst operational improvements continue quarter on quarter, the zinc price continues to decline, falling a further 9% in February to around US$2000/t and stretching the mine economics to a level that has substantially increased risks for this operation.

ARQ Group (ARQ) – down 68% for the month (Not held). Yet another disastrous result continues a series of disappointing operational performances. With a market capitalisation sub $20m, net debt above $55m and minimal underlying earnings, ARQ faces serious financial consequences, particularly given the increasingly uncertain global economic environment emerging as a result of COVID-19.

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

LiveTiles (LVT)

LiveTiles provides a cloud-based intelligent workplace platform used across more than 1000 organisations worldwide, and growing. Essentially, it is a flexible workplace platform that consolidates all content across all systems in a corporation, into a personalised corporate dashboard via an intranet home page. In other words, the dashboard can be tailored for each individual's or department's needs within an organisation. The core benefit LiveTiles provides through its flexible workplace platform is the removal of the high cost that each organisation would need to bear to develop customised coding and management of its intranet and ongoing content changes. Off-the-shelf intranet platforms lack integration to the range of modern workplace applications.

Included in the package are branding and design tools, corporate news and information, employee data management and wellbeing systems, analytics and insights, organisational charting, news and publishing tools, business process automation tools, and artificial intelligence using bots to help customer management engagement and intranet design and integration tools.

LiveTiles has grown from its first customer in February 2015 to now operating with over $52m of annualised recurring revenue (ARR) and 225 employees across the US, UK/Europe and Australia. It has a global relationship with Microsoft, integrating into its systems to effectively deliver the personalised tools it offers organisations. Having had its ups and downs, LiveTiles, through growing its ARR both from new customers and expansion of existing customer revenue, along with stringent cost management over recent quarters, is well placed to achieve cashflow breakeven over the coming 12-18 months.

LiveTiles Platform