Small Companies Strategy – Investment Newsletter

Performance *(As at 30th September 2020)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**-0.99**	**+12.95**	**+18.05**	**+71.35**	**+177.87**	**+17.76**
Small Ords Accumulation Index	-2.82	+5.67	-3.33	+20.90	+54.42	+7.20
Outperformance	**+1.83**	**+7.28**	**+21.38**	**+50.45**	**+123.45**	**+10.56**

Although the JMFG Australian Equities 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 – and is after management fees, taxes (excl imp. credit benefits) and any paid or accrued 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 September*

The JMFG Small Companies Strategy retreated in September, falling 0.99%, however, this compared with a 2.82% decline in its benchmark, resulting in outperformance for the month of 1.83%. The Strategy has outperformed its benchmark for the rolling quarter by 7.28% and by 21.38% for the rolling 12-month period. The annualised return since inception, over six years ago, is now 17.8% compared to the benchmark annualised return of 7.2%. While volatility in returns is to be expected, the portfolio has demonstrated a history of excess annual returns.

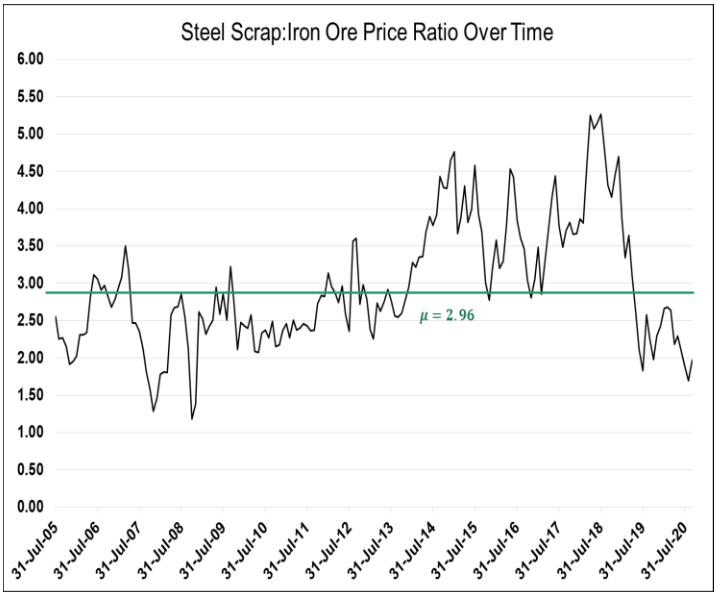
The market was weak across all sectors in September, with the exception of Healthcare, rising +0.9%. The other better-performing sectors for the month included Industrial -0.3%, Property Trusts -1.5%, Telecommunications -2.2%, and Consumer Discretionary -2.6%. The weakest sectors included Energy -11.1%, I.T. -6.8% (consistent with US tech sector falls), Consumer Staples -6.6%, and Financials -6.1%. The ASX Small Ordinaries Index, -2.8% in September, continued to perform better than the larger ASX 200 Index, -3.7%, the former having less exposure to the weaker sectors, in particular Financials and greater exposure to Property Trusts and Consumer Discretionary.

With the weakness in September, we were able to top up where there were significant price falls, and lighten some positions that had performed well. After almost halving our position in Sezzle at the end of August at prices above $10, we added to our position in September at prices below $6. We also added to our positions in Class and Megaport on price weakness, and moderated positions in Opthea, Pacific Knowledge Systems, and Temple & Webster, which all performed well over the month. We also reduced Clover Corp following its somewhat disappointing result, at prices around 10% ahead of current prices. The month saw the addition of two stocks to the portfolio: Uniti Group and LiveHire. Uniti Group is looking to acquire OptiComm under a scheme of arrangement, largely for cash. Adding Uniti Group allows us to maintain our exposure to monopoly residential fibre. Our best performing stocks included Temple & Webster +27%, OptiComm +18%, People Infrastructure +10%, Opthea +9%, and Netwealth Group +8%. Our worst performers were Sezzle -33%, Nearmap -23%, Tesserent -17%, St Barbara -14% and Beach Energy -13%. Our cash position increased from around 15% to 16.5% at month-end.

Chart of the Month – Steel Production Input Prices

Steel scrap and iron ore are interchangeable inputs in the production of steel. While the production methods differ in their use of these inputs, there is a tendency for steel producers to alter production methods in favor of cheaper inputs. Because of this, the price ratio of inputs should tend to revert towards the mean, as steel producers alter their production method.

The chart opposite shows the ratio of Heavy Metal Steel Scrap (HMS1) to the price of 62% Iron Ore. The 15-year average ratio calculated was 2.96x, compared to the ratio on 30 September 2020 of 1.97x. We can see that the ratio hit low levels in both 2007 and 2008. In '07, iron ore had a significant price run-up towards US$200/t, greatly outpacing the scrap steel price at the time, before the scrap price followed in early '08 where HMS1 was a touch over US$500/t. This was before both iron ore and scrap steel prices fell significantly at the end of '08 and scrap became relatively cheap. The next 10 years, however, saw the relative price of scrap rise significantly more before falling off in 2018 and continuing its decline through 2019 and 2020. Scrap steel prices once again look relatively cheap.



Source: FactSet financial data and analytics

Best & Worst Performers for September 2020

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Temple & Webster – TPW	Sezzle – SZL	Ardent Leisure Group – ALG	Zip Co – Z1P
OptiComm – OPC	Nearmap – NEA	Alkane Resources – ALK	IOOF Holdings – IFL
People Infrastructure – PPE	Tesserent – TNT	SkyCity Entertainment Group – SKC	Unibail-Rodamco-Westfield – URW

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

Temple & Webster (TPW) – up 27% for the month. TPW continued to rally through September after putting out a strong result in August against a weak market, the highlight being revenue growth through July and August 2020 in excess of 160% ahead of the prior year.

Ardent Leisure Group (ALG) – up 32% for the month (Not held). The court proceedings following the Dreamworld tragedy concluded at the end of September with imposed fines totalling $3.6 million. Ardent Leisure is still down 64% after the price peaked in January.

Sezzle (SZL) – down 33% for the month. After putting out its half year result in August, Sezzle continued falling throughout the start of September before rallying at month-end. We topped up in early September, after selling down in late August when the price was over $10. During September, Sezzle was also added to the S&P/ASX All Technology Index.

Zip Co (Z1P) – down 33% for the month (Not held). Consistent with Sezzle, Afterpay, and the rest of the Buy Now Pay Later space, Zip fell significantly during September. Zip was also added to the S&P/ASX All Technology Index.

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

Uniti Group (UWL)

Uniti started operations in 2012 in Adelaide and shortly after expanded into the Melbourne market. With new management and listing on the ASX in December 2018 and some attractively priced acquisitions along with organic growth, Uniti's revenue and earnings trajectory began to accelerate. This resulted in it becoming a more meaningful player amongst the second-tier communication operators.

The company is led by a management team with strong backgrounds in telecommunications, data centres, and regulatory operations; bringing together senior executives and directors from successful technology companies such as M2, Vocus, iiNet, AAPT, Codan, Redflow, BSA, Axicom, Metronode, and Nextgen Networks.

Through its combined acquisition and organic growth strategy, Uniti has increased overall revenue in the last financial year from $14.3M to $58.2M (up 306%) while keeping operating expenses comparatively under control throughout (increasing just 108% from $15.2M to $31.7M). This cost control helped Uniti achieve a maiden positive net profit of $15.9m for FY20.

Its history of acquisitions and mergers has the company providing three solid pillars of telecommunications business diversity:

- **Consumer & Business** – where Uniti provides retail broadband internet & phone services into the residential and small to medium enterprise space
- **Specialty Services** – Uniti provides organisations with bespoke advanced telecommunications data analytics, premium voice services, call tracking, and leasing of phonewords from its extensive catalogue of reserved special phone numbers
- **Wholesale & Infrastructure** – Uniti competes directly with NBN and other fibre providers providing backhaul connection over Uniti-owned fibre, leased third-party fibre, owned fixed wireless – often in locations where no fibre exists – and provisioning of strata developments

Uniti Group is currently moving to take over Opticomm (ASX:OPC), having outbid a competing offer from First State Superannuation Scheme. Acquiring OptiComm will further extend its capacity to continue to win backhaul business from NBN, adding Opticomm's capacity to deploy competitive greenfields and managed housing estate fibre connectivity and services.

OptiComm's Directors have endorsed the Uniti offer, and the shareholder vote is due to be held in the middle of this month. We look forward to seeing a favourable outcome, as our Small Companies Strategy is invested in both Uniti and OptiComm, and we see this acquisition working out well for both entities, and for the Australian telecommunications competitive landscape at large.

The Diverse Income Stream Brands of Uniti Group
(OptiComm takeover approval pending)