Small Companies Strategy – Investment Newsletter

Performance *(As at 31st January 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**-0.73**	**+5.52**	**+15.84**	**+49.88**	**+196.41**	**+17.95**
Small Ords Accumulation Index	-0.25	+11.47	+4.90	+20.46	+75.34	+8.91
Outperformance	**-0.48**	**-5.95**	**+10.94**	**+29.42**	**+121.07**	**+9.04**

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 January*

The JMFG Small Companies Strategy modestly underperformed in January, falling 0.73% against a 0.25% fall for the Small Ordinaries Accumulation Index. It was another month of strong rises for volatile lithium stocks in the index with Galaxy, Ioneer, Orocobre and Pilbara rising between 7 - 29% despite the ASX Small Resources Index falling 1.9% for the month. Strongest sectors across the broader market included Consumer Discretionary +4.7%, Telecommunications +2.7%, Financials +2.2% and Consumer Staples +2.1%. Weakest returns came from Property Trusts -4.1% but this was largely concentrated in larger capitalised names with Property stocks within the ASX Small Ordinaries Index generally performing better. Other weak sectors included Industrials -3.0%, HealthCare -1.9% and Materials -1.1%.

The recent rally in both precious and base metals continued into the early part of January but prices generally stabilised or weakened through the middle and latter parts of the month, which saw several resource companies also weaken in the latter half of the month. The A$/US$ relationship also stabilised through the month around the 0.77 level, compared to 0.70 at the end of October 2020.

For a fourth month running we continued to tilt the portfolio into more defensive stocks, exiting Nearmap and Bravura and replacing them with Elders Limited. We also reduced exposures to PolyNovo, Universal Biosensors, Tesserent, PKS Holdings and Beach Energy. Our PolyNovo selling occurred immediately following their trading update, which in our view was a touch disappointing. Our selling, however, was at substantially higher prices, ~$3.15/share, than where it ultimately settled. In fact, we purchased some stock back later in the month around $2.55/share. We modestly added to position in Megaport, Breville Group, Class Limited and Opthea through the month.

The strongest performers for the portfolio during the month included:

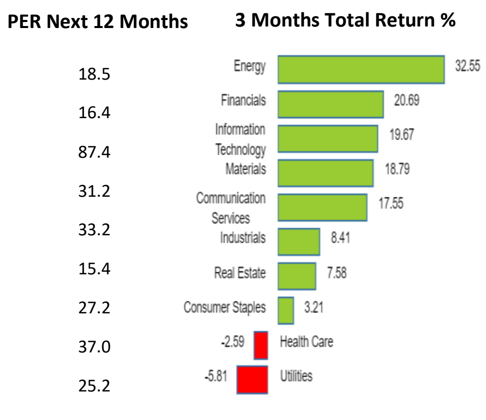
- Sezzle +30%, Pro Medicus +25%, Mach7 Technologies +15% and Breville Group +13%

The weakest performers for the portfolio during the month included:

- PolyNovo -32%, Beach Energy -9%, Imdex -8% and Mineral Resources -8%

Chart of the Month – Waiting For A Correction

We began our discussions around de-risking portfolios several months back, slowly shifting into either lower multiple companies or into companies with more tangible growth opportunities and more sustainable business models. It is interesting to look at sector returns over the past few months as well as total market pricing. Market pricing in terms of forward PER's was expensive when we last spoke about it back in the October 2020 monthly newsletters. At that time, the market was trading on a 12-month forward PER in the order of 18X.



Source: FactSet financial data and analytics

It is now even more expensive with the ASX 200 and ASX Small Companies Indices both trading around 19X the 12-month forward PER. In the context of low interest rates and a recovering economy, some would argue the market may still be reasonable value given the alternatives in the cash and fixed interest markets. There may be some merit to that argument.

It is interesting to look at the best performing sectors over the past three months. They include the economically sensitive Energy and Materials sectors, both of which have experienced a recovery in commodity prices, as well as the Financials and Communication sectors. These four sectors all offer lower multiples and yield. The outlier is the I.T. sector where the two largest I.T. stocks have continued to rally, namely Afterpay and Zero. The remaining smaller I.T. companies have generally underperformed. The weakest sectors include those that did well in the initial pandemic period, including Consumer Staples and Healthcare. In addition, the Real Estate sector continues to suffer from the poorer performing Commercial office sector.

Best & Worst Performers for January 2021

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Sezzle (SZL)	PolyNovo (PNV)	Australian Ethical (AEF)	PolyNovo (PNV)
Pro Medicus (PME)	Beach Energy (BPT)	Zip Co (Z1P)	Tyro Payments (TYR)
Mach7 Technologies (M7T)	Imdex (IMD)	Avita Medical (AVH)	AMA Group (AMA)

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

Sezzle (SZL) – up 30% for the month. Sezzle announced underlying merchant sales of US$321m in the December quarter, up 205% on the prior comparable quarter. It also announced active customer growth of 144% to 2.2 million, active merchant growth of 167% to 26,690 and several other strong growth metrics.

Australian Ethical Investment (AEF) – up 39% for the month (Not held). Company consistently growing funds under management, reported 16.9% increase to $5bn for the quarter with strong investment performance from their ethically filtered portfolio and net fund inflows.

PolyNovo (PNV) – down 32% for the month. A disappointing interim trading update revealed sales growth in the first half of 31%, but within this, sales in the first quarter were 75% higher than the prior comparable period. Sales were slower in October and November.

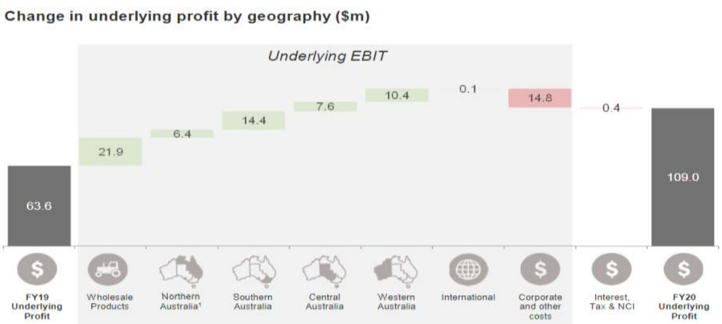
Tyro Payments (TYR) – down 21% for the month (Not held). The company's POS terminal network was down across a small section of its older customer base early in the month, which attracted the attention of overseas shorting efforts; the stock didn't recover despite Tyro rejecting all claims, transparently updating the market on its staged terminal recovery and resuming operations fully by month-end.

Elders (ELD)

Elders is a name that is synonymous with the Australian agricultural industry, operating since 1839 both within Australia and internationally. The company provides a range of services to primary producers including finance, banking and real estate services to wool, grain and livestock trading. Primary producers essentially work with Elders to access products, marketing services and technical advice across retail, agency, and financial products, including insurance and home loans.

After several years of drought in eastern Australia, the agricultural sector is well positioned to enjoy strong earnings with good rains through 2020 continuing into the early part of 2021. Production is forecast to grow and ongoing strength across several soft commodities should see solid earnings through 2021 and potentially into 2022. In the CEO's speech at the Elder's AGM in December, Mark Allison spoke with optimism about the coming year with an average summer crop forecast, following several below average summers. Whilst geopolitical issues are a concern to the agricultural sector in Australia, Elders believes the signing of the Regional Comprehensive Economic Partnership offers stability across export markets for ASEAN, north Asian countries and China, although the latter has proven to be a little more problematic recently.

Elders acquired Australian Independent Rural Retailers (AIRR) mid-November 2019, a national wholesale member based buying and marketing group for independent rural merchandise and pet and produce stores with eight warehouses servicing over 1,500 customers. Aside from cost synergies, access to a broader customer base and product range, the business also helps to diversify away from weather-related cycles, as well as by geography and customer type.



Underlying profit by geography by year ($m)

FY20	**21.9**	**32.6**	**54.3**	**31.2**	**39.2**	**(1.2)**	**(58.5)**
FY19	Nil	26.2	39.9	23.6	28.8	(1.1)	(43.7)
% change	100%	24%	36%	32%	36%	(9%)	(34%)

Source: Elders FY20 Results Presentation

AIRR was integrated into Elders Wholesale Products division through FY20 (year-end September) and was stated to be on track to deliver acquisition synergies through centralization of inventory, consolidation and streamlining procurement as well as enhanced margin management and marketing across brands and product portfolio. Other initiatives include 'own label' expansion in animal health and merchandise and a digital strategy.

AIRR Underlying EBITA **(includes $2.2m FY20 prior to acquisition)**