JM Financial Group

Issue 71: March 2021

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st March 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**+1.99**	**-3.24**	**+64.61**	**+58.77**	**+195.47**	**+17.41**
Small Ords Accumulation Index	+0.79	+2.09	+52.15	+27.12	+79.45	+9.05
Outperformance	**+1.20**	**-5.33**	**+12.46**	**+31.65**	**+116.02**	**+8.36**

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 March*

The rotation to so-called 'value' stocks continued in March with low PER and typically higher-yielding sectors performing the best. Consumer Discretionary increased 7.03% through the month, with Utilities rising 6.80%, Property Trusts +6.56%, Telecommunications +6.24%, and Financials +4.31%. Weakest sectors included Materials -3.01%, I.T. -2.95%, Energy +0.02%, and Health Care +2.51%. The ASX Small Ordinaries, with its higher proportion of I.T. and Health Care exposure, was weaker than the broader market through the month, rising 0.79% compared to the ASX 200 which increased 2.44%.

The JMFG Small Companies Strategy managed to outperform its benchmark by 1.20% during the month, rising +1.99%, to reverse some of the recent underperformance against benchmark which had largely been a function of perceived 'value' stock performing better than 'growth' stocks. Mindful of stronger global economic growth and generally rising longer-dated interest rates, we have repositioned the fund over recent months – away from the stronger-performing I.T. and Health Care names which have benefited the fund over recent years and into companies that are, typically, priced at lower multiples, with higher yields and a larger exposure to domestic earnings.

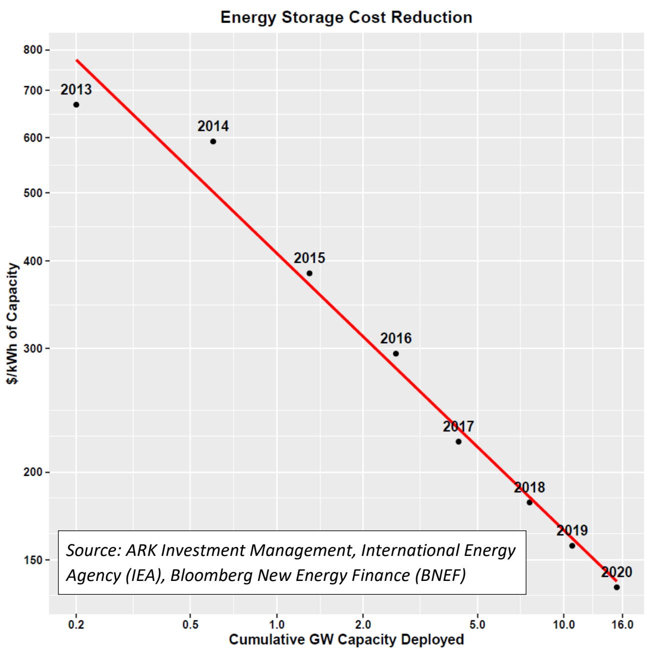
We exited our position in Tesserent during March and added Kathmandu Holdings. Tesserent provided healthy returns for the fund but we felt it had achieved a valuation that required a very successful execution of its aggressive acquisition strategy. Kathmandu is one discretionary retailer that did not benefit from the Covid-19 lockdowns across Australia and New Zealand, aside from the Rip Curl business, and, at a relatively low multiple, we felt it could be a beneficiary over coming months as the vaccination program rolls out and people revert to more normal living. We also added to holdings in Top Shelf International Holdings, Regis Resources and NRW Holdings during the month. The cash position at month end was 9.3%.

The strongest performers for the portfolio during the month included Universal Biosensors +26%, People Infrastructure +20%, Centuria Industrial REIT +14%, and PolyNovo +12%. The worst performers included Megaport -11%, Mach7 Technologies -10%, Medical Developments -8% and Pro Medicus -7%. Notably, our weakest performers for the month all came from the I.T. and Health Care sectors.

Chart of the Month – Energy Storage Costs

Over the last 10 years, battery prices have fallen significantly as global investment in energy storage has increased. The chart to the right demonstrates how the total cumulative amount of power storage capacity deployed relates to the cost to produce the capacity. This substantial deployment of battery capacity has created a cycle in the energy storage market whereby the investment in battery technology leads to innovation and a lower cost to produce the batteries, thereby encouraging further investment. Investment in battery capacity only shows signs of further increasing in the future, based on the continuation of unit cost declines.

The bulk of battery investment is in Lithium-Ion Batteries (LIBs) as these tend to have a long comparable lifespan, charge faster, and tend to be more efficient than other battery types. Lithium-Ion Batteries are also the battery of choice for Electric Vehicles due to their high energy density. As such, electric vehicle manufacturers have benefited from the substantial cost reductions in battery production seen in recent years. Grid-level storage is also on the rise – for example, in January 2021, Origin Energy announced that it was progressing with plans to build Australia's largest battery, with a power capacity of 700MW.



Level 8, 140 Bourke St, Melbourne, VIC, 3000
Ph: +61 3 9627 9900
Web: www.jmfg.com.au
Email: enquiries@jmfg.com.au

Best & Worst Performers for March 2021

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Universal Biosensors (UBI)	Megaport (MP1)	Hansen Technologies (HSN)	Resolute Mining (RSG)
People Infrastructure (PPE)	Mach7 Technologies (M7T)	Mayne Pharma Group (MYX)	Zip Co (Z1P)
Centuria Industrial REIT (CIP)	Medical Developments (MVP)	Grain Corp (GNC)	Ioneer (INR)

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

Universal Biosensors (UBI) – up 26% for the month. No news items were released for the company through the month – however, on the first day of April, the company announced a non-exclusive distribution agreement in Canada for its wine testing device "Sentia". The agreement is for a three-year term with standard renewal and termination options.

Hansen Technologies (HSN) – up 34% for the month (Not held). Hansen Technologies announced a five-year Master Agreement with Telefonica in Germany with an approximate revenue value of $25m. At the same time, it also increased FY21 guidance with expected revenue raised from $306-$316m and EBITDA margin of 37%-39%, above their long-term expected margin of 32%-35%.

Megaport (MP1) – down 11% for the month. Other than Board appointment announcements, there was no news from Megaport through the month. Its poor performance is most likely a function of the I.T. sector performing poorly through March with ongoing sector rotation.

Resolute Mining (RSG) – down 32% for the month (Not held). The Ghanaian Minerals Commission advised Resolute that the Mining Lease for the Bibiani Gold Mine was terminated with no explanation or rationale provided for the termination.

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

Kathmandu (KMD)

Since its IPO in 2009, Kathmandu has diversified its product offering from a winter-dominated range into an all-year-round product spread via the development of summer clothing and hiking products and via the acquisitions of the Rip Curl surfing brand in 2019 for A$350m and the US-based Oboz Footwear business for US$60m in 2018. At the time of the Rip Curl acquisition, the company raised over NZ$175 at NZ$2.55/share to assist with the funding. The timing of the purchase of Rip Curl was unfortunate in that it came just ahead of the Covid-19 pandemic and left the company with a stretched balance sheet in the context of a very uncertain trading environment. In April 2020, the company raised over NZ$200m at NZ$0.50/share to reduce gearing. The company is now well-capitalised with a small net debt position.

Despite the unfortunate timing of the Rip Curl acquisition, the Rip Curl business performed relatively well throughout 2020, delivering $48.7m in EBITDA for the six-month period to January 2021, with comparable sales only 4.3% lower than the prior six-month period to January 2020. The traditional Kathmandu brand, however, suffered greatly with sales declining 35% in the most recent half versus the comparable prior period and EBITDA fell 99%. With the Kathmandu brand's ongoing reliance on winter-related sales and Australia and New Zealand in lockdown for large parts of the autumn and winter months, that part of the business struggled to gain traction with consumers.

With the vaccine rollout now well under way and Covid-19 community transmission largely eliminated from Australia, Kathmandu should have the capacity to begin growing revenue and earnings solidly as it recovers over CY21, especially if normal outdoor winter activities resume through the year. While we are by no means free from further possible lockdowns, the risks appear to be diminishing and Kathmandu should have potential to outperform as its earnings recover. With consensus PER for FY21 at 14.1x and 11.2x in FY22, the business is attractively priced relative to other domestic retailers, many of which were obvious beneficiaries during the lockdown periods. With opportunities to expand the Kathmandu brand geographically, the business has good seasonal spread and organic growth potential.

Source: KMD 1H21 Results Presentation