JM Financial Group

Issue 73: May 2021

Small Companies Strategy – Investment Newsletter

Performance *(As at 31st May 2021)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**-0.03**	**+6.97**	**+32.08**	**+59.05**	**+209.90**	**+17.77**
Small Ords Accumulation Index	+0.27	+6.09	+26.73	+25.58	+88.89	+9.63
Outperformance	**-0.30**	**+0.88**	**+5.35**	**+33.47**	**+121.01**	**+8.14**

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 after management fees (post 1 Jan 2017), performance fees (paid or accrued), GST, and excludes the effect of franking credits. Strategy Inception for Performance Data is July 1st, 2014.

Month in Review – *A review of events that influenced the share market and portfolio in May*

The JMFG Small Companies Strategy was relatively flat for the month of May, falling 0.03%, slightly short of the Small Ordinaries Accumulation Index, which rose 0.27%, resulting in minor underperformance against the benchmark of 0.3%. The Strategy outperformed its benchmark by 0.88% for the rolling 3 months and has outperformed the benchmark by 5.35% for the rolling year after all fees. The annualised return since inception, over six years ago, is 17.77%, compared to its benchmark return of 9.63% p.a.

Financials was the best-performing sector in the broader market, rising 5.7% for the month. Other strong-performing sectors included Consumer Discretionary +3.5%, HealthCare +3.5%, Consumer Staples +2.5%, Property Trusts +1.7%, and Materials +1.7%. The worst-performing sector was I.T., falling 9.9% for the month, reversing its gains of the prior month. Other weaker-performing sectors included Utilities -6.6%, Energy -1.8%, and Industrials -1.0%.

During the month, we added to our position in Alcidion Group at heavily discounted prices, with a group of insiders reducing part of their long-held positions. The decision to increase our stake proved immediately beneficial as the price rose strongly into the end of the month and finished 30.9% above our top-up price. We also added to our existing positions in Regis Resources and Breville Group and exited our position in Infomedia. Centuria Office REIT and Dusk Group were added to the portfolio during the month. Specialty retailer Dusk Group, which sells candles and home fragrances, has performed well following its IPO and continues to trade at a deep discount to other specialty retailers whilst still having the opportunity to open many more stores across Australia. Centuria Office REIT was beaten down along with other office real estate in 2020, and still trades well below its highs despite more than 90% occupancy and high quality tenant exposure. We expect ongoing recovery as the Covid threat diminishes over time.

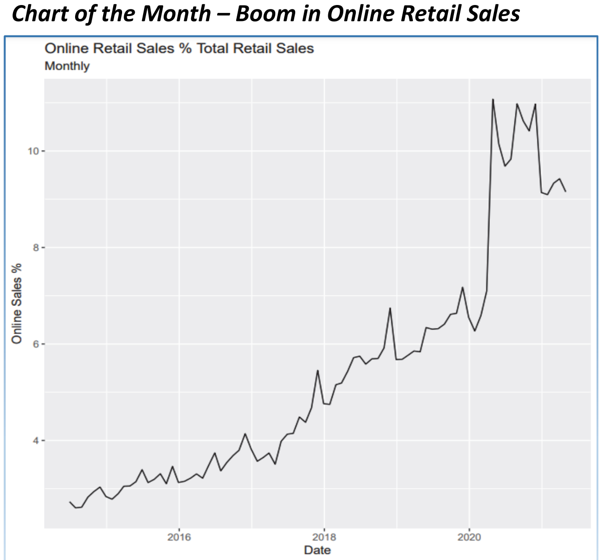
The strongest performers for the portfolio during the month included:

- Alcidion Group +14%, Collins Foods +11%, Kathmandu +11%, and Class +9%

The weakest performers for the portfolio during the month included:

- Costa Group Holdings -27%, Medical Developments -15%, Mach7 Technologies -14%, and Universal Biosensors -10%.

Chart of the Month – Boom in Online Retail Sales



2020 was an outstanding year for online retailers with customers forced into isolation, limiting traditional bricks and mortar shopping. However, many online retailers face difficult year-on-year growth as 2021 sees customers able to return to stores. The graph to the left illustrates this, showing the total online sales as a percentage of total retail sales – 2021 seems to be returning to longer-term trend growth.

During May, online retailer Kogan released a trading update stating that it had increased its inventory in 2020 to support growth, which led to high warehousing costs when consumer demand fell below the levels of 2020. Kogan's share price now sits around 60% below its highest level, achieved in October last year. Several other online retailers are also down significantly from their highs: Temple & Webster Group down 30% from October, Adore Beauty Group down 40%, and MyDeal.com.au down 60% from their respective highs.

There is a clear longer-term trend of Australians shifting, or increasing the number of, their purchases online, it is worth looking into how much of this is persistent rather than transient spending. Businesses with more sustainable models should see continued trend growth.

JMFG Small Companies Strategy		ASX Small Ordinaries Index	
Best	**Worst**	**Best**	**Worst**
Alcidion Group (ALC)	Costa Group Holdings (CGC)	Chalice Mining (CHN)	EML Payments (EML)
Collins Foods (CKF)	Medical Developments (MVP)	Alkane Resources (ALK)	Perenti Global (PRN)
Kathmandu (KMD)	Mach7 Technologies (M7T)	Resolute Mining (RSG)	Nuix (NXL)

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

Alcidion Group (ALC) – up 14% for the month. Alcidion continued its strong share price performance following the acquisition of ExtraMed and the announcement of its selection as preferred provider for a significant Department of Defence contract. In early May, the company announced it was closing its share purchase plan early, being more than 10 times oversubscribed. While several directors and substantial shareholders sold down early in the month on liquidation of a joint investment vehicle, share price rose strongly towards month-end.

Chalice Mining (CHN) – up 27% for the month (Not held). Chalice has been one of the best-performing resource companies in recent years. Priced at $0.12/share in May 2019 with a capitalisation of $31m to $9.13/share in May 2021 and a capitalisation of over $3bn. Chalice's Julimar Project gives the company exposure to palladium, nickel, copper, cobalt, and gold, which have all been experiencing increased demand over the past 12 months.

Costa Group Holdings (CGC) – down 27% for the month. Costa Group is a grower of fruit and vegetables, selling into supermarket chains and grocery stores. While it was anticipated that Costa Group would have a strong 2021 with rainfall and water security having improved over 2020, Costa announced that first half performance would only improve marginally on the prior corresponding period, with a variety of challenges faced in its domestic produce segment.

EML Payments (EML) – down 42% for the month (Not held). EML Payments is a payment card technology company that generates revenue through providing reloadable debit card and gift card services to businesses. During the month, EML announced that the Central Bank of Ireland (CBI) had "significant regulatory concerns". The company also stated that directions to be made from the CBI could materially impact EML's European operations, a segment which constitutes 27% of its revenue.

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

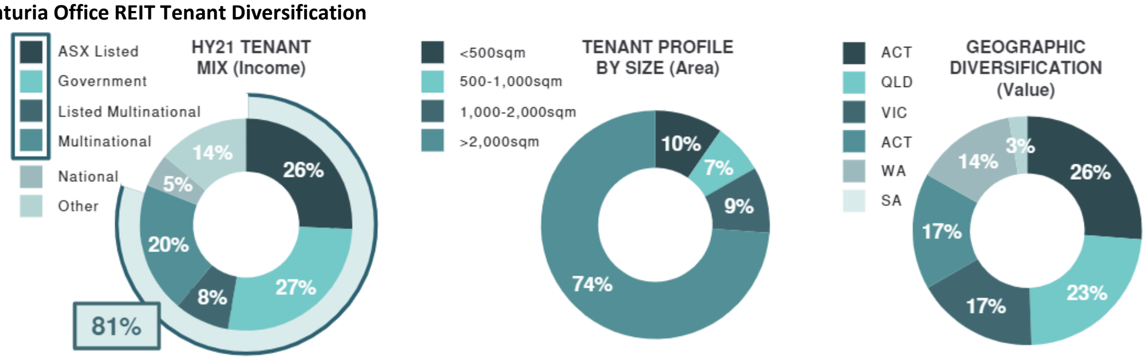
Centuria Office REIT (COF)

Centuria Office REIT owns and operates a diversified portfolio of office properties across Australia and is one of only a few pure-play office REITs listed on the Australian Stock Exchange. While the office real estate market was heavily impacted in 2020 by work from home restrictions, Centuria has managed to maintain relatively high occupancy and rent collections, with over 80% of its income being derived from government and multinational tenants.

While the outlook appears to be improving for office real estate as restrictions are lifted and the COVID-19 vaccine is rolled out, lockdowns continue to impact Centuria's ability to keep office space filled. The company reported that its property occupancy in Victoria was 70.5% at 31 December 2020 compared to 100% a year prior, a far steeper and more persistent decline than in any of Centuria's other geographic segments, with the reduction relating to a large single tenant at its Docklands asset. At year-end, Centuria reported that its occupancy in New South Wales and Queensland was 97.9% and 87.2% respectively, reflecting the superior operating conditions in those states.

While the office real estate market does continue to face difficulties, Centuria has been able to avoid cancelling its dividend and maintain a high level of rent collections. Furthermore, Centuria Office now offers a dividend yield of ~7.50%, one of the highest in the listed REIT space, offering attractive upside should operating conditions for the sector improve as expected over the next two years.

Centuria Office REIT Tenant Diversification



Source: Centuria Office REIT – HY21 Results