JM Financial Group

Issue 82: February 2022

Small Companies Strategy – Investment Newsletter

Performance *(As at 28th February 2022)*	Month (%)	Rolling 3 Months (%)	Rolling 1yr (%)	Rolling 3yrs (%)	Inception Gross (%)	Inception Annualised (%pa)
JMFG Small Companies Strategy	**-3.4**	**-9.9**	**-1.8**	**+51.6**	**+184.4**	**+14.6**
Small Ords Accumulation Index	0.0	-7.7	+5.0	+25.1	+87.9	+8.6
Outperformance	**-3.4**	**-2.2**	**-6.8**	**+26.5**	**+96.5**	**+6.0**

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 reasons, 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 the share market and overview of the portfolio for February*

For the month of February, the JMFG Small Companies strategy fell 3.4%. The strategy underperformed the Small Ordinaries Accumulation Index, which had a flat month, reversing the trend of outperformance from the prior four months. Some portfolio adjustments made in the last few months, while not immediately benefiting the strategy in February, are expected to result in improved performance in the coming months as we remain confident in the underlying growth of these companies. We continue to make refinements to the portfolio to better align the strategy with the current market environment.

The best-performing sectors for the broader Australian market in February were Energy, which continued its rise by a substantial 5.8%, and Consumer Staples, which recovered some of its January decline, up 5.6%. Other rising sectors included Utilities 3.0%, Materials 2.6%, Financials 2.4%, Property 0.9%, and Industrials 0.1%. Sectors which fell through February were Information Technology -6.9%, Consumer Discretionary -5.8%, Communications -2.2% and HealthCare -0.2%.

During February, we continued our buying regime taking advantage of another weakening in prices towards the end of the month. Our cash position decreased from more than 7% at the end of January to less than 5% at the end of February. Our buying activities focused on names we liked in some sectors that were broadly sold off and companies that reported attractively.

The strongest performers for the portfolio during the month included:

- Credit Clear +22%, Regis Resources +15%, Jervois Global +12%, and Webjet +9%

The weakest performers for the portfolio during the month included:

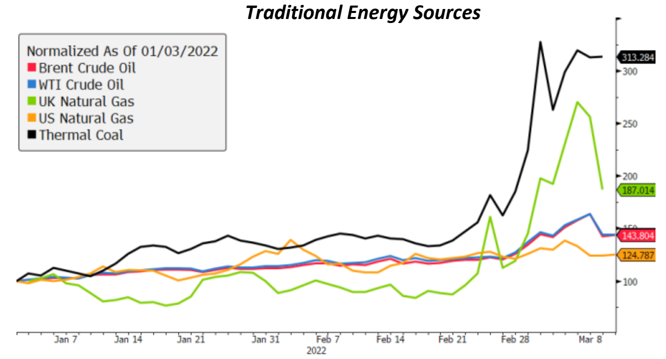
- Medical Developments -27%, Appen -27%, PolyNovo -24%, and Uniti Group -21%

Chart of the Month – *Energy Market*

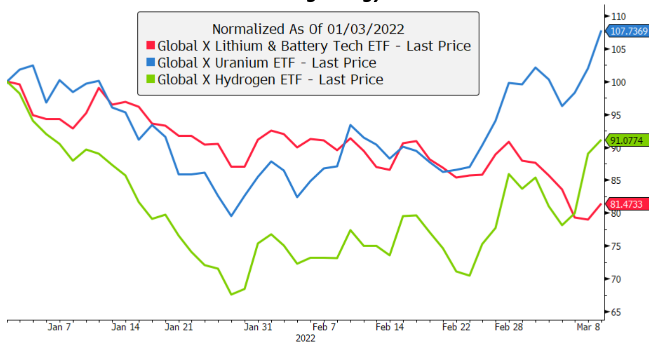
The start of 2022 has seen an interesting reversal in some of the broad energy trends that have led the market in recent years. The charts below show the comparative performance of traditional energy sources and future-facing energy sources over the year to date, demonstrating this clear reversal. Traditional energy commodities, such as crude oil, natural gas, and coal, have all strongly rallied in recent months following the Russian invasion of Ukraine underscoring a multiyear underinvestment in these traditional energy sources as countries have instead been investing in renewables.

Countries globally have announced a move away from cheap Russian energy which will mean more expensive resources will need to be relied upon while the transition to future-facing energy takes place. This comes at a time when global demand is rebounding as international travel returns and economic activity recovers. This strong performance of traditional energy has not been paralleled in the performance of future-facing energy and the equities in these industries have had a bumpy start to 2022. However, while Uranium equities have had a volatile start to the year, their performance is still positive year-to-date. The strong tailwinds of recent years are expected to persist, however, and the need for catch-up investment in traditional energy projects is also likely to be required to fill the gap as the transition takes place over the next decade.

Traditional Energy Sources



Future-Facing Energy Sources



Source: Bloomberg Finance

JMFG Small Companies Strategy - February		ASX Small Ordinaries Index - February	
Best	**Worst**	**Best**	**Worst**
Credit Clear (CCR)	Medical Developments (MVP)	NRW Holdings (NWH)	Life360 Inc (360)
Regis Resources (RRL)	Appen (APX)	Cimic Group (CIM)	Novonix (NVX)
Jervois Global (JRV)	PolyNovo (PNV)	Sims (SGM)	Tyro Payments (TYR)

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

Credit Clear (CCR) – up 22% for the month. During January, Credit Clear was caught up in the sell-off of technology and growth companies, compounded by a large capital raise which put further selling pressure on the share price. However, during February the company released its half-year report where it provided more information regarding the ARMA acquisition and details on the rapid integration within only 8 days of the acquisition completion.

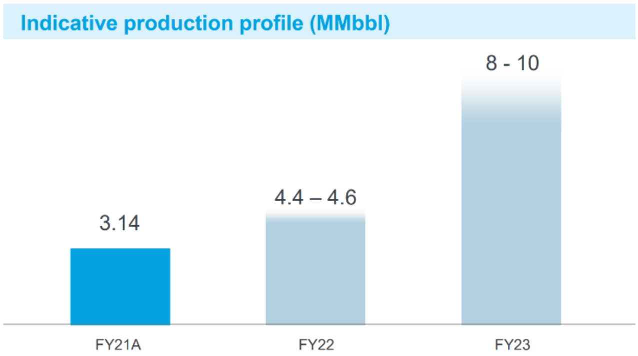
NRW Holdings (NWH) – up 36% for the month (Not held). NRW released its 1H result showing the company achieved EBITDA at the upper end of its previously forecast guidance range, with revenue at $1.1Bn and net profit $45M. In addition, the company extended its Onesteel contract a further 3 years, a deal valued around $600M, and secured a mix of new construction contracts to the value of $100M.

Medical Developments (MVP) – down 27% for the month. During February, Medical Developments issued its half-year report where revenue was down, and the opening loss widened on the prior corresponding period. The announcement also didn't give any clarity on the US FDA Penthrox submission. Fortunately, the company announced in March that the FDA had lifted the clinical hold on Penthrox.

Life360 Inc (360) – down 37% for the month (Not held). Despite releasing strong net growth in subscriber numbers, earnings and acquisition activities, the underlying FY loss of $34M, increasing from $16M, reveals how much it is costing the company to continue to appeal despite subscriber churn and concerns about it on-selling precise location data of its userbase to unrelated third parties. Further, the company blames a recent decline in sales on stalking issues raised with Apple's AirTags products operating in a similar space.

Due Diligence – *A closer look at a Company of Interest* – Karoon Energy (ASX: KAR)

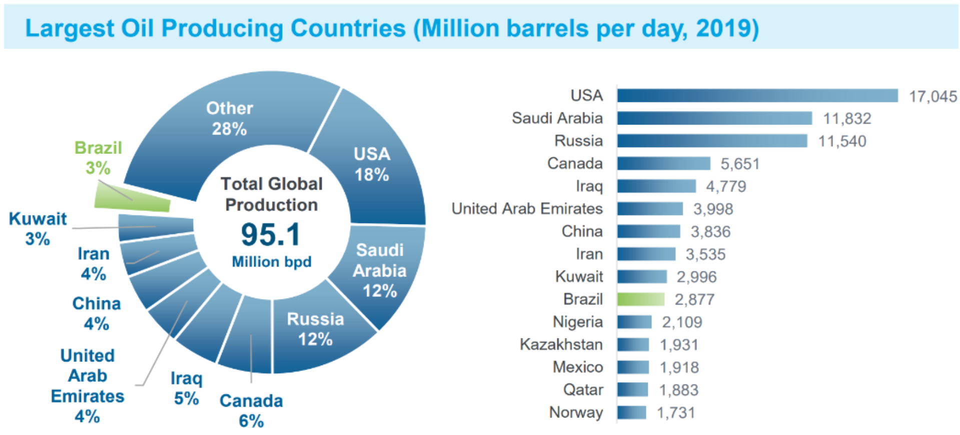
Karoon Energy is an oil producer and explorer with exposure to assets in Australia, Brazil, and Peru. Although Karoon has been in operation for more than a decade, the company undertook a transformational move in 2019 by acquiring the Baúna field in offshore Brazil from Petrobras for US$665m. This acquisition allowed Karoon to transition from being an oil explorer into an oil producer. Now, with a substantial operation running in Brazil, the company sees further development and exploration within its portfolio as drivers for further growth while also noting the potential for attractive M&A opportunities in the region. With the current energy price environment, there is increasing support for new developments which will help Karoon in seeking to continue growth over the coming years.



Source: Karoon Energy 2022 Interim Financial Report

Karoon's production for FY21 was 3.14 MMBbls, and it is on track to substantially increase production over the coming years as investments are made in Baúna, as shown in the chart above. During the December quarter of 2021, the company secured US$160m in debt financing, of which US$30m has been drawn for development and expansion of Baúna. With production expected to more than double during a period of strengthening energy prices, Karoon will generate strong cash flows to fund further development of its resource.

Karoon has noted the potential for M&A in Brazil as a driver for further growth with increasing corporate activity in the area as major producers restructure. Brazilian oil multinational Petrobras, from whom Karoon acquired its Baúna asset, is a large-scale seller in the region and Karoon has highlighted Petrobas as bringing to market high quality opportunities. Petrobras has undertaken a major divestment program to restructure its portfolio to focus on its major producing assets and raising liquidity from non-core assets. However, Karoon has highlighted that, with the recent oil price volatility no available opportunities have passed its acquisition screening conditions.



Source: Karoon Energy 2021 Strategy Refresh Presentation

Given the current geopolitical uncertainty and the energy price volatility it is causing, there is an increasing urgency for secure global supply diversification. Brazil offers less geopolitical risk than many of the larger producing countries, which is likely to encourage further investment in the region. In this regard, Karoon is well situated with its potential for organic and acquisitive growth in the region. Given all these factors, we see Karoon as offering attractive exposure to growth in oil production following years of major underinvestment in this sector.