

# Quality and Value Small and Mid Cap Stocks

February 2021

Since Investors Mutual Limited (IML) was established in 1998, we have always managed our small and mid-cap portfolios with a focus on companies that in our view offer 'quality and value'.

Small and mid-cap stocks are often under-researched, which allows our disciplined, research-led stock selection process to identify underappreciated, quality companies which we believe are undervalued.

We seek out companies which we believe have a strong, sustainable competitive advantage; that are run by experienced and capable management teams; and that can generate a recurring earnings stream which can grow over time. When a company meets these criteria, we seek to buy and own shares in the company only if they are trading at what we believe to be a reasonable price.

The risk management tenets of managing portfolios of smaller companies are varied but we always consider the following:

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**Capital preservation** A focus on capital preservation means remaining patient and only holding stocks that we can justify after detailed research into their quality and underlying valuation. Entering a stock with a 'margin of safety' to its fair value lowers the risk of capital loss. In addition, the lower the entry price, the higher the potential for capital gains as the stock re-rates over the long term.



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**Investing for the long-term**



Investing – as opposed to speculating – means patiently putting together a diversified portfolio of companies that in our view can generate sustainable cashflows for dividends or for further reinvestment in the business. Many investors fail in the long term because they are too busy trying to outperform the market in the short term, often by looking to trade in and out of lower-quality stocks.

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**Dividends**



Acting as a 'safety net' in times of volatility, the level of dividends from a diversified portfolio of quality companies is largely uncorrelated to the level of the sharemarket. When the market declines, the prices of quality companies with recurring earnings can fall just as readily as speculative and riskier companies. However, quality companies with a history of paying healthy dividend streams often recover a lot more quickly than more speculative companies.

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By remaining focused on only owning well-managed, quality small and mid-cap stocks whose share prices are underpinned by sound fundamentals, we remain confident that we can provide our investors with a prudent and risk-controlled approach to investing over the coming years.

On the following pages, IML's analyst team provides its current view of some key holdings across the Investors Mutual Australian Smaller Companies, Small Cap and Future Leaders Funds.



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## Event Hospitality & Entertainment ASX: EVT

**Event Hospitality & Entertainment** is Australia's largest operator of cinemas in addition to a major hotel operator (primarily via its QT and Rydges brands). The company also owns the Thredbo ski resort.

The company's valuation is underpinned by its \$2bn property portfolio, with material development upside at its two sites on George St in Sydney. Earnings have been affected by the COVID-19 pandemic. However, we expect a rebound going forward driven by a strong slate of blockbuster movies combined with pent-up demand for cinema and a boom in domestic tourism driving demand for both Event's hotels and at Thredbo for the upcoming ski seasons.



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## Home Consortium ASX: HMC

**Home Consortium** is a developer, owner and manager of real assets. Home Co currently manages 47 properties with a value of \$1.7 billion. HMC's core assets boast a high quality tenant base, with exposure to major grocery (Woolworths, Coles, Aldi), retail category killers (Chemist Warehouse, Spotlight, Dan Murphy's, Supercheap Auto) and government-supported services.

Home Co is in the process of transitioning from a retail landlord to a capital light asset manager. Already, one standalone REIT has been launched and we expect another to be launched during 2021, with a focus on tenants specialising in health and wellness. The continued development of the asset management model supports ongoing earnings growth. We consider the management team to be highly capable and aligned with shareholders.



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## Integral Diagnostics ASX: IDX

**Integral Diagnostics** is the 4th largest diagnostic imaging (DI) provider in Australia across 47 locations in Victoria, Queensland and Western Australia, as well as a leading provider in New Zealand.

The DI sector has attractive fundamentals with industry growth supported by an aging population, an increasing prevalence of chronic disease and advances in technology allowing for early diagnosis, screening and treatment.

Management continues to grow margins in the existing business by optimising staff to patient demand, utilising technology to improve the patient and referrer experience and through higher utilisation of MRT, PET and CT services to drive efficiency. Management also continues to assess strategic acquisitions that are a clinical fit, strategically aligned and earnings accretive and the company has a very good track record in this regard.



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## Metcash ASX: MTS

**Metcash** is Australia's largest food, hardware and liquor wholesaler, supplying well-known neighbourhood retailers including IGA, Mitre 10 and Cellarbrations. In the last few years, the company has invested heavily in efficiency programmes to ensure that its retailers can compete effectively with their larger competitors.

Metcash received an unexpected boost during the COVID-19 lockdown as more shoppers switched to the convenience of neighbourhood stores. This has led to the company gaining market share from competitors – which we believe is partly sustainable given the improvements independent retailers have made in their stores in recent years. IML likes Metcash because of the company's ability to produce strong cashflows and sustainable earnings underpinning a steady dividend going forward as well as its attractive valuation.



### Nine Entertainment

ASX: NEC

**Nine Entertainment** is the largest media company in Australia spanning the television, streaming video, online real estate, newspaper publishing, radio and digital media sectors.

A sharp rebound in TV advertising is driving near-term earnings upgrades, however long-term value creation at Nine is being driven by continued strong growth of the company's digital assets. It is estimated that digital revenue streams will account for 60% of earnings by FY22. Subscriber growth at Stan accelerated through the pandemic and the recent long-term NBC Universal deal assists in securing premium content for many years into the future. The ongoing listings recovery at Domain and the expectation of carriage fees being agreed with Google and Facebook are also expected to provide tailwinds to earnings in the years ahead.



### Pact Group

ASX: PGH

**Pact Group** is a manufacturer and supplier of rigid plastic and metal packaging in Australia, New Zealand and increasingly internationally. The company primarily converts plastic resin into packaging and related products for customers in the food, beverage, chemical, agricultural and industrial sectors.

The company is increasingly positioning itself into the circular economy through its growing pooling operations in areas such as returnable plastic crates and garment hangars which are used to service the supermarket and retail clothing sectors respectively. The company is also in the process of divesting its contract manufacturing division.

A refreshed management team is refocusing on the company's core packaging division while bringing improved capital allocation discipline to the business. The strategic pivot towards a focus on sustainable solutions, we believe, will provide a source of sustainable competitive advantage and significantly improve returns over time.



### Southern Cross Media

ASX: SXL

**Southern Cross Media** is Australia's largest radio station owner, controlling the Today and Triple M networks throughout the five capital cities and around half of the country's regional radio network.

The company also owns a network of regional TV stations under an affiliation with Nine Network. While not a high growth industry, radio is cash generative and has traditionally been a very stable advertising medium.

After raising equity in March 2020 Southern Cross now has a strong balance sheet and is positively exposed to an improving advertising market. We also view the company as a potential target in the event of further media sector consolidation such as a private equity funded combination with an outdoor advertising player.



### Tabcorp

ASX: TAH

**Tabcorp** owns valuable gaming licences across the lotteries and wagering sectors throughout Australia. We view Tabcorp's lotteries division as one of the best businesses in the Australian market as it is a monopoly business which holds long-term licences and with earnings growth to be driven by increased digital penetration and new and enhanced games. The segment now accounts for more than half of the company's earnings.

IML welcomed the recent arrival of the new Chairman and the management team renewal being undertaken by Tabcorp. We believe Tabcorp has the opportunity to extract substantial cost savings from its operations and will benefit from a heightened focus on its wagering division.

## About IML's Small and Mid Cap Portfolio Managers



### Simon Conn

#### Senior Portfolio Manager - IML Mid & Small Caps

**Simon** is the portfolio manager for the Investors Mutual Future Leaders Fund, Investors Mutual Australian Smaller Companies Fund and the Investors Mutual Small Cap Fund. In addition, Simon co-manages QV Equities Limited, a Listed Investment Company focused on the ex-20 sector.

Simon joined IML in 1998 as a founding member of the investment team and has been a Senior Portfolio Manager in the small and mid-cap sector since 2002.

Simon holds a Bachelor of Economics and a Bachelor of Laws from the University of Sydney. Simon is a qualified solicitor and is a Fellow of the Financial Services Institute of Australasia.



### Marc Whittaker

#### Assistant Portfolio Manager - IML Mid & Small Caps

**Marc** is portfolio manager for the Investors Mutual Future Leaders Fund, alongside Simon Conn. Marc also assists Simon Conn with portfolio management responsibilities for the Investors Mutual Australian Smaller Companies Fund and the Investors Mutual Small Cap Fund. Marc is also an analyst for a range of small-cap stocks.

Marc commenced his funds management career in 1999 as an equities and research analyst and is a CFA Charterholder and a member of the CFA Society of Sydney.

Marc holds a Bachelor of Commerce with Honours from the University of Sydney and a Bachelor of Laws from the University of Sydney.

## Further Information

For more information about Investors Mutual Limited, please contact your financial adviser, or call us on 1300 551 132 or visit [iml.com.au](http://iml.com.au)