

Three small caps to keep an eye on

26 November 2019 | Roger Montgomery, Montgomery Investment Management

There is no doubt that Australia's small companies market has the ability to generate significant wealth. This is because stockbrokers don't earn enough revenue from brokerage on small companies and therefore don't research them, leaving them undiscovered and potentially very cheap.

Secondly, by fostering innovation, the listed Australian small companies' market provides investors with access to new business models, products and services on, or close to, the ground floor.

For Australian investors, the small companies market also provides a means of beating the market. That's because unlike experiences elsewhere in the world, a majority of Australian active small company fund managers beat the index. By randomly selecting a small 'cap' fund manager, investors have a better than 50 per cent opportunity to outperform their passive investing brethren. Conduct a little due diligence and the odds are bound to improve. Of course, small companies' funds must remain small and nimble themselves to be able to invest and generate meaningful returns. Consequently, many of them are now closed to new investors.

And it is potentially risky investing in smaller companies without the required experience and particularly, without knowledge of management. The surest way of winnowing the winners from the losers is to know the management of the company intimately. The truth is that a little less than two thirds of all stocks in the small cap index over the last decade have produced a negative average return, and only slightly more than one third have produced a positive return. In other words, for every Afterpay winner there are two Dick Smith disasters.

Investors would be wise to rely only on reputable and experienced managers in the small capitalization sector of the market. I spoke to Gary Rollo and Dominic Rose of the Montgomery Small Companies Fund to find three small caps worthy of mention.

EML Payments (ASX:EML)

EML is a structural growth 'fintech' specialising in digital gift cards and pre-paid cards for corporate clients across Australia, Europe and North America. Leveraging its leading technology platform, the company has strategically targeted large and growing industry verticals requiring innovative and customised payment solutions, such as gaming and wagering, shopping malls, salary packaging, and neo-banking. We like the scalability of the business model and see strong upside potential from the recently acquired Prepaid Financial Services business. You can read [Dominic's article on EML Payments here](#).

Imdex Limited (ASX:IMD)

IMD is a mining services company with solid leverage to gold exploration and development activity. The key attraction for us is the strong IP within the business – the company's leading-edge instruments significantly increase drilling productivity which reduces costs for clients and provides a moat around the

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business during a cyclical downturn. The company is commercialising some exciting new tools which should underpin solid earnings growth over the medium-term investment horizon.

Infigen Energy (ASX:IFN)

IFN is a renewable energy generator, positioned to benefit from change happening to our energy market. Its recent acquisition of two gas peakers to “firm” its intermittent renewable supply, allows it to contract significantly more of its available capacity than otherwise, and likely at better prices. Which should lead to stronger and more certain earnings growth. At a \$650 million market cap IFN is now just starting to appear on the radar of larger funds looking to play the renewables theme.

The Montgomery Small Companies Fund own shares in EML Payments, Index and Infigen Energy. This article was prepared 26 November with the information we have today, and our view may change. It does not constitute formal advice or professional investment advice. If you wish to trade any of these companies you should seek financial advice.

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