

# DNR Capital Australian Emerging Companies Fund

## Performance Report – December 2020

### Performance

The DNR Capital Australian Emerging Companies Fund increased 6.15% (net of fees) in December, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 3.39%. Over the last 12 months the Fund increased by 19.04%, outperforming the Index by 9.83% (net of fees).

### Market review

The past year has certainly been eventful, and one we will look back on for many years to come. We witnessed a one in a hundred-year pandemic due to COVID-19, which effectively froze large parts of the global economy. It resulted in significant equity market volatility as we experienced a painful market correction, followed by an equally stunning recovery. Unprecedented levels of fiscal and monetary stimulus provided support, as governments and the major central banks went “all-in” to backstop the global economy. It has certainly highlighted the unpredictability of markets, and the importance of building resilience into portfolios by investing in quality companies with strong balance sheets.

Reflecting on the environment in early 2020, especially as the severity of COVID-19 was becoming more apparent, it is remarkable that the small cap index ended the year in positive territory. We will take a number of lessons from 2020, however a key one was reiterated once again. This is the importance of focusing on the long-term fundamentals for a business, rather than being distracted by volatility and short-term focused news flow. Ultimately, it is the long-term cash flows that are the primary driver of valuations, not the short-term earnings outlook which the market appears to consistently overreact to.

The calendar year ended strongly for the Fund, with the overweight position in resources a key contributor to the outperformance. We have discussed our more positive view on the sector in recent months. Valuations are highly attractive (especially relative to many overpriced growth stocks which have now been priced for perfection), with the protection of net cash balance sheets and free cash flow yields well above the market. We also see an improving outlook for commodity prices as the global economy reopens, with demand growth set to accelerate. New supply growth is also limited given the overhang of the last commodity supercycle, setting the stage for a potential multi-year earnings recovery.

Within the mining sector, we are particularly positive on commodities exposed to growth in renewables investment and the transition to electric vehicles. Demand here is set to rise substantially over the coming decade, leading to future market deficits (demand > supply). Given this positive outlook, it was pleasing to see IGO announce a transformational acquisition in the lithium sector during December. By acquiring a stake in the Greenbushes mine in Western Australia (the largest hard rock lithium mine in the world), we believe the company will firmly establish itself as one of the highest quality exposures to electric battery minerals on the ASX.

### Fund overview

APIR Code	PIM4357AU
Investment bias	Style neutral with a quality focus
Designed for	The Fund is designed for investors seeking a medium-longer term investment focused on achieving growth, with less focus on generating excess income. The investor is prepared to accept higher volatility in pursuit of higher growth.
Investment objective	The Fund's investment objective is to invest in a portfolio of Australian emerging companies that aims to outperform the Benchmark (net of fees) over a rolling five-year period. The investment objective is not a forecast of the Fund's performance.
Benchmark	ASX/S&P Small Ordinaries Accumulation Index
Investable universe	Australian equities and cash
Investment constraints	The Fund will not invest in derivatives
Investment guidelines	Maximum exposure to an individual security is 15% of Fund NAV
Asset allocation	Australian Equities – 80-100% Cash – 0-20%
Risk level	High
Number of securities	Min 20 - max 45
Minimum suggested investment timeframe	5 years
Buy/sell spread	+0.30% / -0.30%
Management fee	1.15% p.a. of the NAV of the Fund (inclusive GST and RITC)
Performance fee	20% of outperformance of the Fund relative to the Fund's Benchmark (after the management fee)
Minimum initial application amount	\$20,000
Minimum further application amount	\$5,000
Minimum withdrawal amount	\$5,000
Valuation and unit pricing frequency	Each business day
Distribution frequency	Semi-annual
Responsible entity	The Trust Company (RE Services) Limited as part of the Perpetual Limited group of companies
Entry/exit fees	Nil

## Net active return as at 31 December 2020

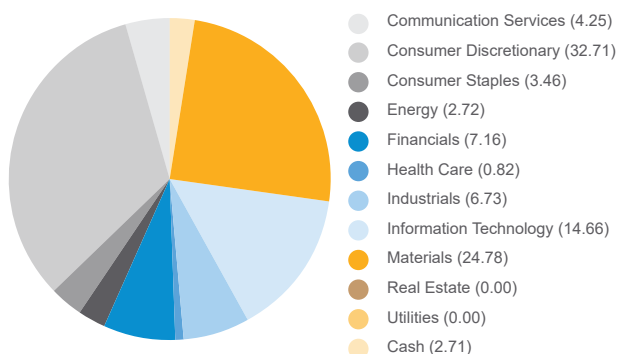
	1mth %	3mth %	6mth %	1yr %	2yr %	Incep.* %
Emerging Companies Fund	6.15	14.96	24.85	19.04	26.87	12.62
S&P/ASX Small Ordinaries Accumulation Index	2.76	13.83	20.28	9.21	15.12	5.76
<b>Excess return</b>	<b>3.39</b>	<b>1.13</b>	<b>4.57</b>	<b>9.83</b>	<b>11.75</b>	<b>6.86</b>

\* Inception Date—August 2018

Source: Mainstream Fund Services and DNR Capital

Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry fees or taxation.

## Sector weightings %



Source: Mainstream Fund Services and DNR Capital

## Monthly - top contributors and detractors

### Top 3 contributors

IGO  
City Chic Collective  
Iluka Resources

### Top 3 detractors

IDP Education  
Corporate Travel Management  
IPH

\* Alpha is the fund return less benchmark return. These tables represent the stocks contribution of alpha to overall fund alpha and is determined by the stocks active weight relative to the benchmark and share price return relative to the benchmark.

The main detractors to the Fund's relative performance during December were companies exposed to the reopening global economy, like IEL and CTD. Interestingly, with COVID-19 cases continuing to accelerate in the Northern Hemisphere, these companies have now retraced the bulk of the gains made since the positive vaccine announcements were made during November. We continue to focus on the long-term recovery potential for these opportunities, and have taken advantage of the recent sell-off to increase the Fund's holdings.

## Top 5 active holdings (alphabetical order)

City Chic Collective  
IDP Education  
IGO  
Lovisa Holdings  
Lynas Corporation

Source: Mainstream Fund Services and DNR Capital

As we look to 2021, we again highlight the importance of taking a long-term view when investing in the Australian small cap sector and staying disciplined on valuations. In our view, the most compelling opportunities in the current market are in those sectors of the market set to benefit from a reopening global economy, and an improving outlook for global growth. This requires looking past the challenging near-term outlook due to the impact of the pandemic, and assessing companies based on a more normalised environment in a post COVID-19 world.

The top stock contributors for the month were:

- IGO (IGO):** Acquired an interest in the Greenbushes lithium mine located in Western Australia. Greenbushes is a high-quality lithium mine with low-cost production, long reserve life (+29 years) and high grade. IGO will pay US\$1.4b which will be funded by a combination of US\$1.1b debt and an equity raise, which we participated in. IGO is in the process of selling its gold Tropicana stake which is expected to raise c\$750m–\$1b, with the proceeds to reduce debt. This is a transformational deal for IGO and consistent with management's strategy. IGO now has pure-play exposure to the increasing demand for battery materials to support the expected growth in electric vehicles and renewable energy.
- City Chic Collective (CCX):** Announced the acquisition of leading UK plus-size brand Evans out of receivership from the Arcadia group. Evans has a 90-year history with a strong customer base and market position. The acquisition is for the ecommerce assets and excludes the 100-store network which had been shrinking as consumers' transition to the digital channel. This provides CCX with its first foray into the UK and given CEO Phil Ryan's knowledge of the business for close to a decade, should de-risk the entry. The purchase price of \$41m will be funded from CCX's cash balance, which stood at \$121m at 30 November. This leaves ample capacity for further strategic acquisitions.

- Iluka Resources (ILU):** Outperformed on the back of firmer mineral sands prices. ILU shares also benefited from its 20% stake in iron-ore royalty player Deterra, which it recently demerged. The iron ore price closed above US\$160t after Brazil's Vale announced it has reduced its iron ore output for 2021 by between 40–80t, which is equivalent to 2.5–5% of supply, worsening the deficit position and supporting strong iron ore prices.

The top stock detractors for the month were:

- IDP Education (IEL):** Gave back some of its vaccine-related share price gains from the prior month. Further rises in COVID-19 cases globally continue to highlight the challenging conditions near term. The long-term prospects for IDP Education is bright with pent-up demand from students and IDP's leading market position poised to deliver strong growth when international borders inevitably reopen.
- Corporate Travel Management (CTD):** Gave up some of its vaccine-related share price gains from the prior month. Further COVID-19 outbreaks domestically have led to the closure of state borders, delaying the recovery of corporate travel. CTD has the liquidity and balance sheet to withstand this temporary setback and is well positioned to benefit once travel normalises.
- IPH Limited (IPH):** Underperformed as the strengthening Australian dollar against the US dollar will weigh on IPH's translated profits. On the positive, management is actively looking at acquisitions offshore so a stronger currency will make these targets more attractive. While the market continues to focus on the currency headwinds near term, we believe IPH represents compelling value with strong cash generation, high returns and strong balance sheet.

## Investment strategy

DNR Capital's security selection process has a strong bottom-up discipline and focuses on buying quality emerging businesses at reasonable prices. The process involves comprehensive company and industry research, company visits and meetings, and detailed valuation analysis and modelling. This information is used to assess the quality of a business, and the expected return.

The portfolio construction process considers stock weightings based on the risk versus the expected return. It is also influenced by a top-down economic appraisal, sector exposures and liquidity considerations.

The investment strategy of the Fund is intended to result in a concentrated portfolio that is high conviction and invests for the medium to long-term.

## Investment philosophy

DNR Capital believes a focus on quality will enhance returns when combined with a thorough valuation overlay. DNR Capital seeks to identify good quality emerging businesses that are mispriced by overlaying DNR Capital's quality filter, referred to as the 'quality web', with a strong valuation discipline.

## Platform access

- BT Panorama
- BT Wrap
- HUB24
- Macquarie Wrap
- Netwealth
- Praemium

## Disclaimer

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