

DNR Capital Australian Emerging Companies Fund

Performance Report – November 2020

Performance

The DNR Capital Australian Emerging Companies Fund increased 10.09% (net of fees) in November, underperforming the S&P/ASX Small Ordinaries Accumulation Index by -0.18%. Over the last 12 months the Fund has outperformed its Index by 5.65% (net of fees).

November saw a strong market rally, with optimism towards the recovery increasing following the release of positive COVID-19 vaccine data. The widespread distribution of a vaccine will certainly have positive implications for equities, especially the more cyclical and hardest hit parts of the market. As a result, November saw a significant rotation within the market, with the more expensive growth/defensive stocks underperforming. The key outperformers included the reopening beneficiaries along with the more value/cyclical stocks that will do better as growth accelerates.

We continue to believe in the importance of focusing on the long-term opportunities. This means looking through the challenging short-term outlook, and focusing on the environment from 2022 onwards. Just as the market was surprised by trends during the lockdown (like the shift to online), we think the market will underestimate the extent of the recovery. We see significant pent-up demand for in-person activities like eating out in restaurants, attending events, shopping in physical stores, travelling for leisure or work, and demand for foreign university education. These activities are likely to rebound sharply as the pandemic is brought under control, which we think has significant implications for sector positioning over the coming year.

Many of the strong outperformers over the last year are unlikely to be the same companies leading the market over the year ahead. For example, many of the lockdown beneficiaries have been priced for perfection, with high valuations and optimistic earnings assumptions. As a result, we have materially reduced the Fund's exposure to these companies. This includes holdings in the technology, payments, healthcare and consumer sectors. For example, we recently sold out of Zip Co (Z1P) following the strong share price recovery this year. Having originally invested in the buy now, pay later space several years ago, we now see a less attractive risk-reward outlook. Along with a higher valuation, there are also signs of increased competition in the sector, which is likely to put downward pressure on returns.

Sectors of the market we are more positive about include the quality cyclicals, reopening beneficiaries, and commodity-related companies. Valuations for these opportunities remain highly attractive, with material earnings upside as the recovery strengthens. For example, we recently added the mining company Deterra Royalties (DRR) to the Fund. The company generates high levels of cash flow from its royalty over BHP Group's (BHP) iron ore mine in Western Australia, where production will more than double over the coming years. DRR was recently demerged from the mineral sands producer Iluka Resources (ILU), with management focused on becoming a larger and more diversified mining royalty company. This will be a unique opportunity on the ASX, with shares trading at a material discount to international peers.

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 30 November 2020

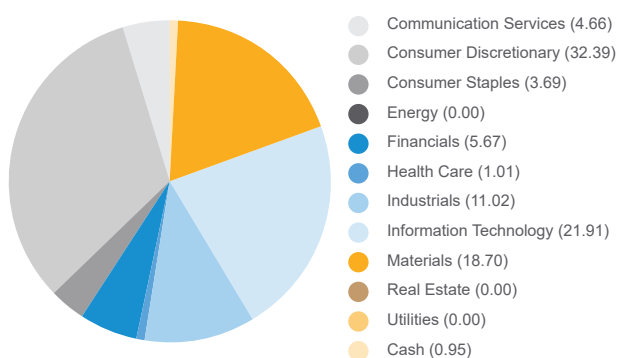
	1mth %	3mth %	6mth %	1yr %	2yr %	Incep.* %
Emerging Companies Fund	10.09	4.83	12.47	11.63	18.72	10.17
S&P/ASX Small Ordinaries Accumulation Index	10.27	7.66	14.78	5.98	11.17	4.71
Excess return	-0.18	-2.83	-2.31	5.65	7.55	5.46

* 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

Lovisa Holdings
Corporate Travel Management
Jumbo Interactive

Top 3 detractors

Pushpay Holdings
ARB Corporation
Tyro Payments

* 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.

Top 5 active holdings (alphabetical order)

Bravura Solutions
Corporate Travel Management
IDP Education
IPH
Lovisa Holdings

Source: Mainstream Fund Services and DNR Capital

Market review

Positive contributors to performance

Lovisa Holdings (LOV)

LOV shares rallied on the back of positive vaccine news as the market begins to reprise a resumption in normalised trading conditions. LOV provides good exposure to economies reopening as increased store traffic and resumption in gatherings and events bodes well for increased demand for LOV's products. Later in the month LOV announced the acquisition of the European store network of German wholesaler beeline GmbH, which is expected to add more than 80 stores to the LOV global store network. This is a significant transaction to accelerate LOV's global store expansion.

Corporate Travel Management (CTM)

CTM was an obvious candidate to outperform on the back of positive vaccine news. Having navigated a difficult environment by controlling costs and managing liquidity, we believe the business will emerge from the downturn in a stronger competitive position.

Jumbo Interactive (JIN)

JIN secured approval for a remote gambling software operating licence in Great Britain. This licence allows JIN to expand its footprint in the UK as it supports and powers lotteries of any size or level of sophistication.

Negative contributors to performance

Pushpay (PPH)

PPH upgraded guidance for the year ending 31 March 2021 to earnings before interest, taxes, depreciation, amortisation and fair value adjustments (EBITDAF) of between US\$54m and US\$58m, up from US\$50–\$54m. Yet it was disappointing to see shares materially underperform as the market sought value and cyclical names at the expense of growth companies. PPH is a high-quality company with a leading competitive positioning, generates strong free cash flow and is reasonably priced, which is a rarity relative to many software peers. We believe the structural tailwinds of digital payments, while accelerated by COVID-19, will continue.

ARB Corporation (ARB)

ARB shares sold off along with other pandemic beneficiaries as the market begins to focus on companies that should benefit from economies reopening. There is no question ARB has seen a pull forward in demand and is benefiting from the closure of borders, however

our focus remains on the bigger picture with a more favourable back drop for new car sales and growth in the US. New car sales have turned positive after 30 months of contraction and demand in the US is strong after securing partnerships with Ford, which should underpin sales momentum well into future years.

Tyro (TYR)

TYR shares sold-off, which was disappointing as we expected the shares would respond more positively to the vaccine news given the COVID-19 disruption first started to negatively impact its business in March 2020. We expect sales to continue to accelerate into the next year as the economy re-opens.

Fund positioning

Increasing mining exposure given an improving outlook

An area of the market we have been increasing the Fund's exposure to in recent months has been the mining sector. Looking at the supply side for the key commodities, we've now witnessed a long period of capital discipline since the last commodity super cycle. On the demand side, we believe the outlook is set to improve as global growth strengthens during the economic recovery. There are also new sources of demand driving growth, like the renewables industry and electric vehicles. This will have positive implications for commodities like the base metals, rare earths and lithium. In addition, most commodities are trading below incentive prices (the level required to incentivise new supply), which implies further upside for prices. Overall our focus has been to position the portfolio in the higher quality commodity producers, which requires a low-cost position, strong cash flow generation, long mine life, strong balance sheet and management who are disciplined allocators of capital.

Positive on market leaders strengthening their competitive positions

We see attractive opportunities in market leaders that are likely to emerge from the pandemic with even stronger competitive positions. For example, those companies that were well placed going into the downturn, and where management has not wasted the crisis. This may have included opportunistically acquiring competitors to expand market share, or by investing in technology through the downturn. For example, LOV and CTM have both acquired competitors at attractive valuations, expanding their market share in Europe and North America respectively. IDP Education (IEL) continued to invest heavily in technology during the downturn, enabling it to continue offering services online to foreign university students. By strategically investing during the downturn, either organically or via acquisition, we believe these companies will be well positioned during the recovery, increasing the market share and earnings potential.

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

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