

DNR Capital Australian Emerging Companies Fund

Performance Report – November 2021

Performance

The DNR Capital Australian Emerging Companies Fund increased 1.68% (net of fees) in November, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 1.99%. Over the last 12 months the Fund increased by 39.89%, outperforming the Index by 21.45% (net of fees).

Market review

Equity markets saw a return of volatility during November, selling-off in the final weeks of the month. Following the strong recovery since early 2020, several concerns are starting to weigh on the outlook. Inflationary pressure continues to build across supply chains, bringing into question the sustainability of extremely accommodative monetary stimulus. Several of the major central banks have started stepping away from the “transitory” narrative to describe the recent pick-up in inflation, which suggests that stimulus measures will soon be unwound. Meanwhile, the emergence of the new Omicron COVID-19 variant highlights that a full re-opening may not be a straightforward process.

One of the risks we have been highlighting in recent months is the significant dispersion in both quality and valuation across the small cap universe in Australia. The valuation dispersion between high and low priced companies has reached a multi-decade high, with many of the more growth areas of the market reaching valuations that leaves very limited room for error. In fact, we see substantial downside risks for a number of highly priced stocks in the small cap index, with valuations well ahead of any reasonable valuation based on fundamentals. This compares to other sectors of the market like resources, where companies are seeing strong earnings growth and valuations are attractive.

There are also a number of highly speculative companies in the small-cap Index at present, without the usual quality characteristics we are looking for. They typically have unproven business models, with limited revenue or profits. This is one of the key themes over the past year, with the market prepared to ascribe considerable value to profitless companies, in the hope of significant growth in the future. For example, two of the top negative contributors to the Fund’s relative performance during November included Novonix (NVX) and Chalice Mining (CHN) (both are not held in the Fund). These companies have appreciated considerably over the past year, with a combined market capitalisation of >\$10b, yet they are generating close to zero revenue. Whether the companies achieve their lofty ambitions we will wait and see, however the issue is they already appear well and truly priced for success.

In response to these risks, we have been conservatively positioning the Fund away from the key areas of concern in the market, focusing instead on investing in high quality business models, generating strong cash flows and with prudent balance sheets. This includes industry leaders with strong pricing power to pass through inflationary pressures,

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 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	+0.25% /- 0.25% (effective 3 December 2021)
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 2021

	1mth %	3mth %	6mth %	1yr % p.a.	2yr % p.a.	3yr % p.a.	Incep.* % p.a.
Emerging Companies Fund	1.68	-0.51	15.40	39.89	24.96	25.39	18.58
S&P/ASX Small Ordinaries Accumulation Index	-0.31	-1.54	7.27	18.44	12.04	13.54	8.76
Excess return	1.99	1.03	8.13	21.45	12.92	11.85	9.82

* 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.

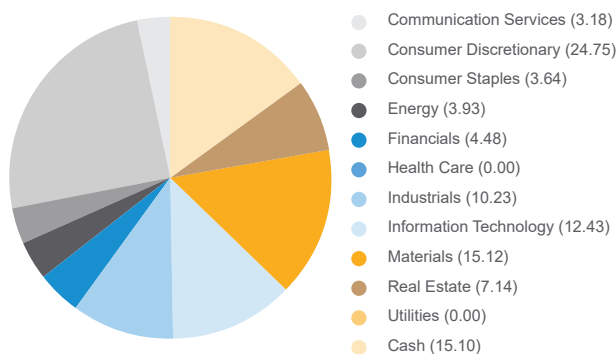
and a range of commodity producers where we continue to see a positive outlook. We are remaining disciplined on valuations, taking profits on holdings that have reached or exceeded valuation hurdles. We have also been avoiding the more speculative areas of the market, which are likely to come under the most pressure as central banks start to withdraw liquidity from the market and interest rates rise. The Fund's weighting in cash is more elevated at 15%, which should provide flexibility to take advantage of the greater volatility we expect going forward.

Top 3 active holdings (alphabetical order)

IPH
Iress
PEXA Group

Source: Mainstream Fund Services and DNR Capital

Sector weightings %



Source: DNR Capital

Attribution

The key stocks contributing to the Fund's monthly relative performance include:

Contributors

- PEXA Group (PXA):** reaffirmed prospectus FY22 forecast revenue, earnings before interest, taxes, depreciation, and amortisation (EBITDA) and net profits after tax (NPAT) at its AGM. PXA's strong start to the year has given the company confidence in achieving its prospectus forecasts. Property market strength has continued, particularly in Sydney and Melbourne, following the easing of COVID-19 restrictions.
- Reece (REH):** has seen strong momentum in the first quarter of FY22 with group sales up 13%. The US provides a sizeable opportunity for REH so it was pleasing to see US sales revenue grow 18.6% on a constant currency basis.

- Lynas Rare Earths (LYC):** Lynas Rare Earths continues to experience strong demand for its rare earths minerals as demand for electric vehicles and wind energy accelerates. Chair, Kathleen Conlon commented at its AGM they are seeing heightened customer and government interest in securing reliable and diversified rare earth supplies. As the only significant producer of rare earths outside of China, LYC is well positioned to address this supply chain challenge.

Detractors

- Temple & Webster Group (TPW):** continues to experience strong tailwinds given buoyant housing conditions and ongoing adoption of online shopping. While the strong growth rates may begin to normalise as COVID-19 restrictions ease, the long-term structural growth remains strong.
- Novonix (NVX, No Holding):** is a battery technology company with a market capitalisation c\$6b, generating revenue for FY21 of \$5.7m and \$7.2m in operating losses. The 61% share price rise on seemingly little fundamental newsflow detracted from the funds relative performance.
- Chalice Mining (CHN, No Holding):** a mining exploration company, announced its maiden resource for the Julimar project in Western Australia. The share price rose 49% during the month taking its market capitalisation to over \$3b. This valuation is difficult to reconcile given the size of the resource, implying shares are priced for further exploration success.

Monthly - top contributors and detractors

Top 3 contributors

PEXA Group

Reece

Lynas Rare Earths

Top 3 detractors

Temple & Webster Group

Novonix (No Holding)

Chalice Mining (No Holding)

* 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.

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

- AMP MyNorth
- BT Panorama
- CFS FirstWrap
- HUB24
- Macquarie Wrap
- Mason Stevens
- Netwealth
- Praemium

Disclaimer

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