

DNR Capital Australian Emerging Companies Fund

Performance Report – March 2022

Performance

The DNR Capital Australian Emerging Companies Fund increased 6.67% (net of fees) in March, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 1.41%. Over the last 12 months the Fund increased by 23.80%, outperforming the Index by 14.12% (net of fees).

Market review

A war in Europe, persistent inflation and the US Federal Reserve ceasing its asset purchases, all failed to deter markets. The S&P/ASX Small Ordinaries Accumulation Index posted strong gains, led by strength in resource and energy stocks. The invasion of Ukraine and the sanctions on Russia will lead to both higher energy prices and higher food prices. Russia and Ukraine are key suppliers of oil, gas, coal, wheat, iron ore and fertilisers. Europe is in a precarious situation, particularly Germany with up to half of its energy requirements supplied from Russia. The predicament is that most commodities are entering deficits after years of underinvestment. Furthermore, renewable forms of energy such as wind and solar are not readily available to fulfil this shortfall, highlighting the importance of fossil fuels to solve the energy crisis. Other ramifications from the sanctions add complexity to global supply chains, which showed fragility during the COVID-19 pandemic. We could be witnessing the beginning stages of de-globalisation as countries look to bring supply chains closer to home, which could ultimately prove inflationary. The Fund benefited during the month from its overweight positions in resource and energy stocks such as IGO (IGO) and Whitehaven Coal (WHC). We continue to believe this sector offers attractive investment opportunities and remains an under-owned segment of the market. Valuations remain cheap trading on single-digit multiples, double-digit free cash flow yields and strong balance sheets. Importantly, this segment of the market is experiencing earnings upgrades as well as providing inflation protection.

We saw some pockets of strength in growth stocks, but continue to be cautious on this part of the market given that many companies are trading on elevated multiples and peak margins. We took advantage of the share price strength in certain Consumer Discretionary names to continue to reduce our exposure. The valuation dispersion between high price to earnings (PE) and low PE multiple stocks is still large, suggesting the former could be at risk of further multiple compression if we enter a sustained period of both higher inflation and higher interest rates.

The yield curve inversion is gaining plenty of market attention given its historical record in predicting recessions. The most followed yield curve is the US 2yr & 10 yr bond. When this inverts it means the longer end of the curve is implying rate cuts in anticipation of a growth slowdown. On past occasions when the curve inverted, recessions followed in 8 out of 10 instances. We are also mindful that energy price shocks are good lead indicators for recessions and we have started to see consumer confidence turn lower. However, looking at the shorter end

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%
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 March 2022

	1mth %	3mth %	6mth %	1yr % p.a.	2yr % p.a.	3yr % p.a.	Incep.* % p.a.
Emerging Companies Fund	6.67	-1.12	3.61	23.80	46.07	20.78	17.11
S&P/ASX Small Ordinaries Accumulation Index	5.26	-4.21	-2.27	9.68	29.18	9.64	7.04
Excess return	1.41	3.09	5.88	14.12	16.89	11.14	10.07

* Inception Date—August 2018

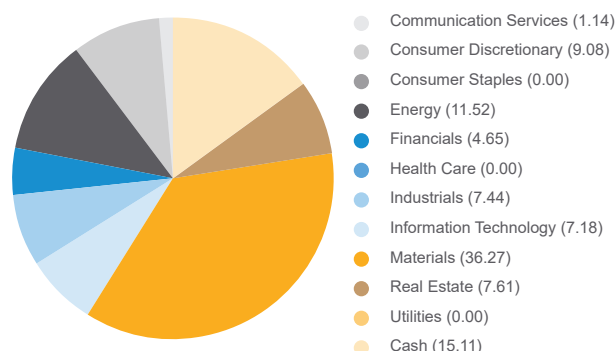
Source: Mainstream Fund Services and DNR Capital

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.

of the curve (3 month & 18 months) tells a different story with the spread steepening. To complicate matters further, the inflation adjusted US 2 yr & 10 yr bond is not inverted as shorter term inflation expectations are higher than the long. Another point to consider is how predictive bond markets are when central banks have been the marginal buyer, artificially suppressing yields over the years. The key takeaway is that macro forecasting is difficult so we try not to express strong macro views in the Fund.

We are operating in a highly uncertain environment and a number of different scenarios can unfold. Ultimately we are focused on identifying strong bottom-up investment opportunities, in quality companies trading on attractive valuations. We expect that market leadership going forward could come from a narrower selection of companies, which will require a more concentrated and benchmark agnostic approach to managing the Fund. To take advantage of these opportunities, the Fund is currently diversified across 22 high conviction holdings, with limited overlap versus the benchmark. Although this means that returns could differ more materially from the benchmark in the short-term, we believe this approach will better position the Fund to take advantage of the opportunities we are currently identifying. Key positions in the Fund include a number of industry leaders, which benefit from strong pricing power to pass through greater inflationary pressures. We are positive on a number of high quality commodity producers, generating strong cash flow and where the supply/demand outlook remains attractive. We also like a number of re-opening opportunities, where we expect earnings to bounce back sharply as the disruption from the pandemic recedes. The Fund maintains a healthy cash balance of 15% which we will look to deploy as opportunities emerge in the coming months.

Sector weightings %



Source: DNR Capital

Top 3 active holdings (alphabetical order)

IPH
PEXA Group
Whitehaven Coal

Source: Mainstream Fund Services and DNR Capital

Attribution

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

Contributors

- **Whitehaven Coal (WHC)** shares benefited from the sanctions imposed on Russia. Russia's exports of thermal coal account for 20% of global demand. WHC commenced its on market share buy-back spending \$67m for 16.8mshares.
- **IGO (IGO)** shares benefited from robust lithium and nickel prices. The nickel price experienced a short squeeze after nickel giant Tsingshan was forced to cover its nickel short position following margin calls.
- **Allkem (AKE)** is benefiting from strong market conditions with lithium carbonate pricing for the March quarter coming in 9% higher than previous guidance to >US\$27k/tonne. Similarly spodumene concentrate prices remain strong at US\$2,200/tonne.

Detractors

- **PEXA Group (PXA)** gave back share price gains following a strong month where it upgraded prospectus FY22 earnings before interest, taxes, depreciation, and amortisation (EBITDA) forecasts by 15%, aided by strong property volumes.
- **IPH (IPH)** trailed the strong market given its defensive characteristics and the strengthening Australian dollar creates a headwind for its US dollar earnings.
- **Lovisa Holdings (LOV)** gave back share price gains following a strong month where it reported earnings growth of 49% despite the ongoing challenges and disruptions faced from COVID-19.

Monthly - top contributors and detractors

Top 3 contributors

Whitehaven Coal
IGO
Allkem

Top 3 detractors

PEXA Group
IPH
Lovisa Holdings

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

This document has been prepared by DNR Capital Pty Ltd, AFS Representative - 294844 of DNR AFSL Pty Ltd ABN 39 118 946 400, AFSL 301658. It is general information only and is not intended to be a recommendation to invest in any product or financial service mentioned above. Whilst DNR Capital has used its best endeavours to ensure the information within this document is accurate it cannot be relied upon in any way and you must make your own enquiries concerning the accuracy of the information within. The information in this document has been prepared for general purposes and does not take into account the investment objectives, financial situation or needs of any particular person nor does the information constitute investment advice. Before making any financial investment decisions you should obtain legal and taxation advice appropriate to your particular needs. Investment in the DNR Capital Australian Emerging Companies Fund can only be made on completion of all the required documentation. The Trust Company (RE Services) Limited ABN 45 003 278 831 AFSL No 235150 (as part of the Perpetual Limited group of companies) is the issuer of the PDS for the Fund. An investor should obtain and read the PDS and target market determination and consider their circumstances before making any investment decision. The PDS and target market determination are available at the Fund website at www.dnrcapital.com.au/invest, or a paper copy can be obtained, free of charge, upon request by calling DNR Capital Pty Ltd ('Manager'), the investment manager of the Fund. This material is general information only and not an investment recommendation. The Manager or The Trust Company (RE Services) Limited does not guarantee the repayment of capital from the Fund or the investment performance of the Fund. An investment in this fund is subject to investment risk including loss of some or all of an investor's principal investment and lower than expected returns.

Office address

Level 23
307 Queen Street
Brisbane QLD 4000

Postal address

GPO Box 3263
Brisbane QLD 4001

Telephone

07 3229 5531

Email

info@dnrcapital.com.au

Website

www.dnrcapital.com.au