

# DNR Capital Australian Emerging Companies Fund

## Performance Report – June 2022

### Performance

The DNR Capital Australian Emerging Companies Fund decreased 8.64% (net of fees) in June, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 4.45%. Over the last 12 months the Fund decreased by 4.94%, outperforming the Index by 14.58% (net of fees).

### Market review

The sell-off in equity markets accelerated during June, with the major central banks continuing to signal the need for tighter monetary policy to bring down elevated levels of inflation. With the central banks now prioritising fighting inflation, rather than growth, an economic slowdown is the key risk facing the global economy. This risk weighed on equities during the month, with the S&P/ASX Small Ordinaries Accumulation Index falling 13.09%, taking the calendar year-to-date decline to -23.74%. Cyclical companies more sensitive to the economic cycle were some of the worst hit, as were the more speculative areas of the market, where excessive risk taking in lower quality business models continues to unravel.

The Fund outperformed the Index during the month, benefitting from its quality bias and defensive positioning, with the higher cash weighting providing some downside protection. Last year we substantially reduced the Fund's exposure to the more expensive sectors of the market like consumer discretionary and technology. Many of these companies were priced for perfection in an environment of low interest rates, with high valuation multiples and optimistic earnings assumptions. These companies have been some of the worst performers this calendar year, with valuations de-rating sharply as interest rates shift higher. We have been taking advantage of this sell-off to add to some of these opportunities selectively, in particular those quality business models where we remain confident in the long-term outlook, and where valuations have now reached levels that are more attractive.

As we approach the upcoming earnings season, the downside risks to earnings from a slowing economy is likely to be the key focus. Some companies have been significantly over earning in recent years, benefiting from a long period of low interest rates, limited cost pressure and strong revenue growth. These positive tailwinds are now reversing, with higher interest rates, rising costs and the impact of slowing growth on revenue. With central banks now focused on reducing demand, earnings could fall sharply as revenues fall on inflated cost bases. As a result, we are still staying cautiously positioned, as we still do not see this risk fully reflected in consensus forecasts or market valuations.

### 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 30 June 2022

	1mth %	3mth %	6mth %	1yr % p.a.	2yr % p.a.	3yr % p.a.	Incep.* % p.a.
Emerging Companies Fund	-8.64	-13.24	-14.21	-4.94	20.19	13.32	11.69
S&P/ASX Small Ordinaries Accumulation Index	-13.09	-20.39	-23.74	-19.52	3.55	0.38	0.42
<b>Excess return</b>	<b>4.45</b>	<b>7.15</b>	<b>9.53</b>	<b>14.58</b>	<b>16.64</b>	<b>12.94</b>	<b>11.27</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.

## Market review

During June, the key contributors to the Fund's relative performance were the more defensive holdings. This included IPH (IPH), a leading provider of intellectual property services, and Iress (IRE), a provider of software to the financial services industry. Both companies benefit from recurring revenue streams and resilient margins. Beach Energy (BPT) also positively contributed to the Fund's performance, with the unfolding energy crisis highlighting the constrained supply following a long period of underinvestment in traditional energy markets. Negative contributors were some of the more cyclical holdings, which fell on concerns around slowing economic growth.

In recent months, we have reduced the Fund's exposure to the Materials sector, with the total weighting now close to the Index. This compares to being overweight in the sector since late 2020, following which the sector has been a strong outperformer versus the Index. Although the supply side challenges in a number of commodities are likely to persist, we are conscious that the impact of a slowing global economy on demand is likely to be the primary driver of commodity prices and the sectors performance. Our focus continues to be on the higher quality producers, positioned low on the cost curve, and with strong balance sheets to withstand any near-term volatility in prices.

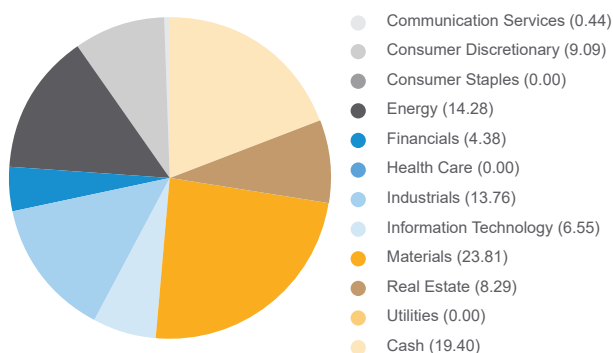
We continue to look for strong bottom-up investment opportunities, in quality companies trading on attractive valuations. Key positions include a number of industry leaders, which benefit from strong pricing power to pass through greater inflationary pressures. We are also positive on business models with recurring revenue streams, which can withstand the uncertain economic environment we are experiencing. We remain positive on several of the higher quality commodity producers, in particular those generating strong cash flows, and where we expect significant capital to be returned back to shareholders. The Fund maintains a higher cash weighting, which we will look to deploy as opportunities emerge in the coming months.

## Top 3 active holdings (alphabetical order)

Deterra Royalties  
IPH  
PEXA Group

Source: Mainstream Fund Services and DNR Capital

## Sector weightings %



Source: DNR Capital

## Monthly - top contributors and detractors

### Top 3 contributors

Whitehaven Coal  
Iress  
Beach Energy

### Top 3 detractors

Champion Iron Limited  
Index  
NIB Holdings (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.

## Attribution

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

### Contributors

- **IPH (IPH):** defensive characteristics saw its shares outperform against the broader market sell-off. IPH continues to demonstrate stable earnings and cash flow generation.
- **Iress (IRE):** with the market selling off on growth concerns, IRE benefited from its recurring revenue stream, inexpensive valuation and ongoing share buyback.
- **Beach Energy (BPT):** benefiting from tightness in energy markets, particularly the domestic east coast gas market where it supplies 12% of demand. BPT remains net cash and fully funded to support future projects from operating cashflows.

### Detractors

- **Champion Iron Limited (CIA):** shares fell on concerns around economic growth and the impact of COVID-19 lockdowns in China on steel demand.
- **Imdex (IMD):** shares fell due to concerns around the economic slowdown and reduced commodity investment.
- **NIB Holdings (NHF, No Holding):** outperformed, detracting from the Fund's relative return.

## 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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### 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](mailto:info@dnrcapital.com.au)

### Website

[www.dnrcapital.com.au](http://www.dnrcapital.com.au)