DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report February 2023

Performance

The DNR Capital Australian Emerging Companies Fund decreased 4.91% (net of fees) in February, underperforming the S&P/ASX Small Ordinaries Total Return Index by 1.21%. Over the last 12 months, the Fund increased by 0.14%, outperforming the Index by 8.11% (net of fees).

Net active return as at 28 February 2023

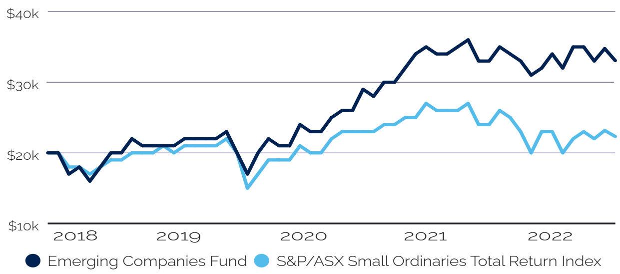
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	4yr p.a. %	Incep.* p.a. %
Emerging Companies Fund	-4.91	-6.20	-4.04	0.14	17.37	13.87	11.82
S&P/ASX Small Ordinaries Total Return Index	-3.70	-1.21	-2.01	-7.97	4.24	3.58	2.47
Excess return	**-1.21**	**-4.99**	**-2.03**	**8.11**	**13.13**	**10.29**	**9.35**

* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

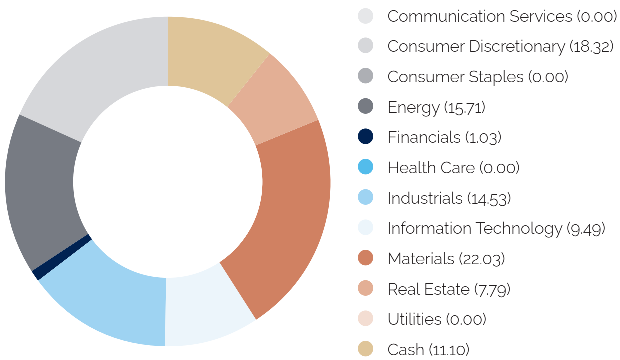
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

Growth of $20,000 since inception



Source: DNR Capital and Apex Fund Services

Sector weightings %



Source: DNR Capital and Apex Fund Services

Top 3 active holdings (alphabetical order)

Security details
IPH (IPH)
Iress (IRE)
PEXA Group (PXA)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors
Stanmore Resources (SMR)
Core Lithium (CXO, no holding)
Paladin Energy (PDN, no holding)

Top 3 detractors
Monadelphous Group (MND)
PEXA Group (PXA)
Whitehaven Coal (WHC)

Source: DNR Capital and Apex Fund Services

A team with global experience

Sam Twidale
Portfolio Manager
CFA

Mark Sedawie
Portfolio Manager
CFA

Fund and market review

Equity markets gave back most of the strong start to the calendar year as attention turned to reporting season. Results came in below expectations with earnings misses outweighing earnings beats. Weaker results came from the Consumer Discretionary sector with soft trading updates reflecting a cautious consumer due to cost of living pressures. The more resilient results came from Consumer Staples as consumers traded down, as well as Information Technology companies with recurring revenues. A key theme coming out of reporting season was difficult operating conditions. While supply chain pressures have eased, wage price growth presents a key challenge. Wages are growing at the fastest pace since 2007 and presents a concern for the Reserve Bank of Australia (RBA) that the Australian economy remains overheated despite ten consecutive interest rates rises.

The Fund trailed the Index during the February reporting season. IPH (IPH) produced a strong result yet softer near-term patent filing trends and currency impacts weighed on the shares. PEXA Group (PXA) delivered a solid result despite a difficult property environment yet delays to the UK impacted investor sentiment. Monadelphous Group (MND) announced delays in the timing of awards and commencement of new major projects. A strong result by Lovisa Holdings (LOV) was not rewarded by the market as they begin to cycle difficult comparable sales. Stanmore Resources (SMR) produced a strong result on strengthening coking coal prices.

Engineering company MND produced a solid result driven by high demand from its resource and energy customers thanks to robust commodity prices. A key highlight was improved margins despite the challenges the company is facing from skilled labour shortages. The maintenance and industrial services division accounts for 70% of the groups' revenue and has proven more resilient given the planned maintenance work and sustaining capex of its customers. The engineering and construction division is lumpier, driven by the timing of awards and commencement of new major projects. This was evident at the result presentation as management called out revenue which is expected to decrease this year before ramping up in 2024. While near-term delays weighed on shares, the longer-term outlook is strong. The transition to decarbonisation will require significant investment in lithium, copper, nickel and rare earths. We also believe traditional fossil fuels will play an important part given the transition to a carbon neutral world will take decades instead of years. End customers are well capitalised to commence new projects given years of underinvestment and depleting reserves.

Reviewing other mining and energy results has increased our conviction in the long-term outlook for the sector. Continued delays to new projects due to labour constraints and upward revisions to capital expenditure highlight the challenges in bringing on new supply on time and budget. With cost curves moving up, higher commodity prices are required to incentivise new supply. While the near-term demand outlook is uncertain and likely to remain volatile, the long-term outlook for a range of commodities is positive. Multiple commodities are in deficit and the recent cyclical bout of weakness represents a good buying opportunity for patient investors. We are focussed on the higher quality mining companies with strong balance sheets, generating cash flows and low-risk brownfield expansion opportunities. Valuations are attractive with many trading at or close to replacement value, providing downside protection.

Digital property exchange company PXA delivered a credible result given the challenging market conditions. Transaction volumes were down 9% compared to the first half of FY22, reflecting a softening housing market from higher interest rates. Refinancing volumes were robust as consumers look to refinance in the rising interest rate environment. The PEXA Exchange is proving resilient with EBITDA margins maintained in the 50-55% range. The UK expansion remains on track but is taking longer to onboard lenders. The PXA share price reflects a free option on UK success and the core Australian exchange is trading on an attractive through-the-cycle multiple. PXA holds a monopoly position providing critical digital infrastructure for the Australian property market.

Reviewing the outlook across the Australian small cap sector, we believe that more attractive opportunities are starting to emerge, especially for long-term focussed investors prepared to look through all the near-term uncertainty. Investors do need to remain selective however, focussing on quality business models that have the ability to protect margins during a period of rising costs. The valuation gap between cheap and expensive sectors also remains wide, requiring us to stay disciplined on valuations.

A key focus has been to identify de-rated quality companies, where the market has become overly cautious on the short-term outlook. Following the recent market correction, we are seeing an increasing number of these opportunities to add to the Fund, especially now that both valuations and consensus earnings forecasts are re-basing lower. As we deploy the Fund's elevated cash holding into these opportunities, this saw the cash weighting decrease from 19.45% to 11.10% during the month.

Performance attribution

Contributors

- **Stanmore Resources (SMR):** completed its transformational year after acquiring BHP's BMC coal assets for US$1.6b. SMR delivered US$1.5b EBITDA and has substantially de-geared the balance sheet with net debt of US$183m.
- **Core Lithium (CXO, no holding):** shares fell on declining lithium prices. The Fund has no exposure to exploration/development lithium companies.
- **Paladin Energy (PDN, no holding):** the Fund has no exposure to uranium stocks which fell during the period.

Detractors

- **Monadelphous Group (MND):** announced delays in the timing and award of new major projects, impacting revenue this year before ramping up in 2024.
- **PEXA Group (PXA):** delivered a credible result given the challenging property market. Delays in on boarding lenders in the UK impacted investor sentiment.
- **Whitehaven Coal (WHC):** shares fell as thermal coal prices dropped below US$200/t. WHC generated $2.7b in EBITDA for the half, with $2.5b in cash on the balance sheet.

Fund Facts

Inception date: August 2018

Minimum initial investment: $20,000

Risk level: High

Management fee: 1.15% p.a. of the NAV of the Fund

Performance fee: 20% of outperformance of the Fund relative to the Fund's Benchmark (after the management fee)

Entry/exit fees: Nil

Buy/sell spread: +0.25%/-0.25%

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.

About DNR Capital and the Fund

Concentrated: Investing in 20-45 highest conviction, quality small cap Australian listed equities.

Style neutral and quality focussed: A disciplined approach to quality and valuation. Concentrated portfolios of quality companies maximise the opportunity for outperformance.

Global & domestic investment experience: Portfolio managers with global and domestic research experience, helps to identify globally competitive emerging companies.

Aligned team: Portfolio managers are invested in the Fund.

Proven process: DNR Capital was established in 2001 and a consistent firm-wide investment process has delivered more than 19 years of investment outperformance.

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