

DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report March 2023

Performance

The DNR Capital Australian Emerging Companies Fund decreased by 0.28% (net of fees) in March, outperforming the S&P/ASX Small Ordinaries Total Return Index by 0.44%. Over the last 12 months, the Fund decreased by 6.38%, outperforming the Index by 6.81% (net of fees).

Net active return as at 31 March 2023

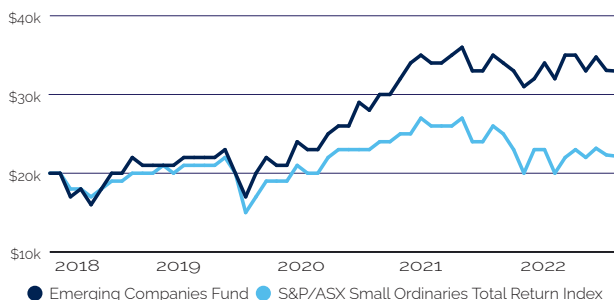
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	4yr p.a. %	Incep.* p.a. %
Emerging Companies Fund	-0.28	-0.75	2.03	-6.38	25.94	13.33	11.52
S&P/ASX Small Ordinaries Total Return Index	-0.72	1.88	9.55	-13.19	13.15	3.42	2.26
Excess return	0.44	-2.63	-7.52	6.81	12.79	9.91	9.26

* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

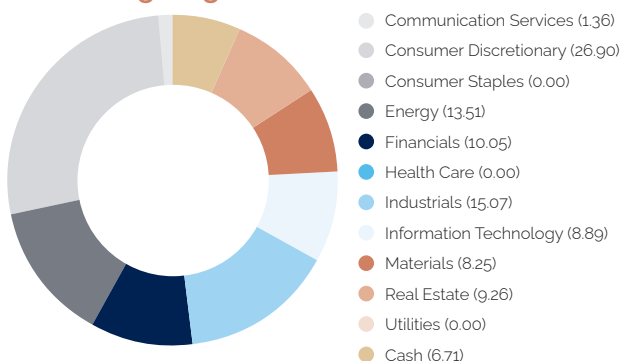
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

PEXA Group (PXA)

Iress (IRE)

Deterra Royalties (DRR)

Top 3 detractors

Liontown Resources (LTR, no holding)

IPH (IPH)

Breville Group (BRG)

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

March was volatile for equity markets, with fears of another banking crisis breaking out after the run-on deposits and subsequent collapse of Silicon Valley Bank (SVB) in the US. Fears quickly spread to the solvency of Credit Suisse, which led to a hastily arranged weekend merger with UBS. The focus on the fragility of the banking system certainly brought back memories of the Global Financial Crisis, with investors fearing the risk of contagion across the banking sector. The potential for tighter credit would be negative for growth, compounding investor concerns of a recession. These events saw the small cap sector selling-off sharply, with the benchmark falling over 5%. Government measures were then announced to stabilise the banking sector, including guarantees for SVB depositors, helping ease investor fears of a wider banking crisis. The market proceeded to recover nearly all the month's earlier losses.

There is considerable fear in the market, with valuation extremes emerging again as investors crowd into the more defensive sectors of the market on recession concerns. With heightened concerns about the risks to the short-term outlook for the economy, we believe it is important for investors to focus on the long-term opportunities in the market. As long-term investors with a more contrarian focus, we continue to look for opportunities in companies we believe will outperform over the long-term, rather than the next 3-6 months.

It is interesting contrasting the outlook compared to 18 months ago, when we initially turned more defensive in the Fund. Optimism has turned to pessimism, and valuations have de-rated considerably. Earnings are being downgraded on recession concerns, which is a catalyst we had been waiting for to turn more positive. Small caps have also underperformed large caps by 20% during this period, offering significant recovery potential when sentiment inevitably improves. Although there are risks of further earnings downgrades given the weakening global economy, valuations are already anticipating this in many cases. We are also conscious that trying to time the market bottom is difficult as share prices are likely to bottom ahead of the trough in the economy.

Over the past two months, we have taken advantage of the recent market weakness, buying shares in high quality companies that have seen significant share price falls. The purchases have been funded by reducing the Fund's cash weighting from nearly 20% to below 10%. We have also sold out of several of the Fund's strong performers over the past year, where valuation upside now appears limited. This includes the coking coal producer Stanmore Resources (SMR), with the shares having increased substantially following the recent rally in coking coal prices.

We believe the most attractive opportunities in the market are now in the higher quality business models that have seen valuations fall substantially, and where the long-term outlook remains highly attractive. This is the case for companies in the Consumer Discretionary, Industrials and Financials sectors, where share prices have fallen between 30-50% or more over the past year. We have substantially increased the Fund's exposure to opportunities in these sectors, with attractive entry points for long-term investors prepared to look through the short-term concerns in the market. Several of these buys are in companies we sold out of when valuations reached historic peaks in late 2021.

The leading global consumer appliance company Breville Group (BRG), is an example of one such opportunity. The shares have underperformed significantly over the past year, with the market concerned about the short-term outlook for consumer spending in a higher interest rate environment. With the shares having nearly halved, we believe it provides an opportunity for investors to buy a high returning company with excellent organic growth potential. Although the company saw a boost in revenue following the COVID-19 induced surge in consumer spending, it was one of the few consumer companies that reinvested these excess profits. Operating margins are still in-line with historic trends, with the company continuing to invest in product development, sales and marketing and its international expansion. Rather than trying to optimise profits in the short-term, we believe this highlights the long-term focus of BRG's management team.

The Fund is positioned across a concentrated number of ideas, focussing on quality business models offering attractive valuation upside over the next 3-5 years. Following recent changes to the Fund's positioning, it is interesting to note that our highest conviction ideas have significantly underperformed the market over the past 12-18 months, with valuations extremely attractive in relative and absolute terms. Our largest sector overweight is now Consumer Discretionary, which compares to being underweight in the sector over the past year, followed by Energy, Industrials, Information Technology and Financials.

We are now underweight in Materials, having been overweight in the sector for the past two years. Valuations have increased substantially since we invested in a range of mining companies when commodity prices were close to the trough. At the time, supply was tight, and demand forecasts were conservative. Over the past two years, this outlook has now changed. Supply for commodities exposed to decarbonisation is increasing materially, with a large number of new mines under development for commodities like lithium and rare earths. The demand outlook also appears less clear, as we believe the

market may have overestimated the speed of the transition towards electric vehicles and renewable energy. In a concentrated portfolio, every stock competes for capital. We are identifying higher quality opportunities in the sectors we have been recently adding like Consumer Discretionary, Industrials and Financials.

Performance attribution

Contributors

- **Pexa Group (PXA):** outperformed on signs the property market is beginning to stabilise with both improved auction clearance rates and listings volumes.
- **Iress (IRE):** rebounded in March as the market looks ahead to the investor day in April with presentations from the management team on strategy and outlook.
- **Deterra Royalties (DRR):** benefitted from resilient iron ore prices. DRR's cornerstone asset is a royalty over BHP's Mining Area C iron ore operation.

Detractors

- **Liontown Resources (LTR, no holding):** received a non-binding indicative proposal from Albemarle Corporation to acquire LTR for \$2.50 per share, a 63% premium to the prior close.
- **IPH (IPH):** detected a cyber security incident with unauthorised access to a portion of its IT environment. New security infrastructure has been implemented and business operations are returning to normal.
- **Breville Group (BRG):** fell on market caution towards consumer discretionary stocks from rising interest rates.

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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.