

# DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report May 2023

## Performance

The DNR Capital Australian Emerging Companies Fund decreased 3.74% (net of fees) in May, underperforming the S&P/ASX Small Ordinaries Total Return Index by 0.48%. Over the last 12 months, the Fund decreased by 1.76%, outperforming the Index by 4.01% (net of fees).

## Net active return as at 31 May 2023

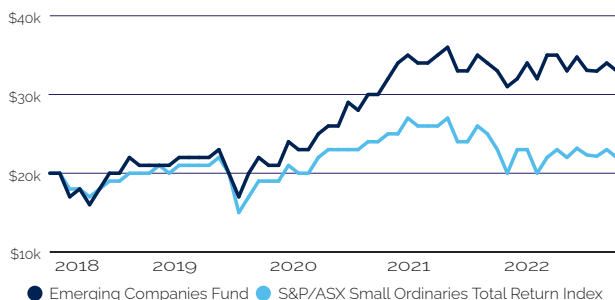
|   | 1mth %       | 3mth %      | 6mth %       | 1yr %       | 3yr p.a. %  | 4yr p.a. %  | Incep.* p.a. % |
|---|--------------|-------------|--------------|-------------|-------------|-------------|----------------|
| Emerging Companies Fund                     | -3.74        | -0.62       | -6.78        | -1.76       | 14.09       | 11.98       | 11.02          |
| S&P/ASX Small Ordinaries Total Return Index | -3.26        | -1.29       | -2.48        | -5.77       | 4.46        | 2.56        | 2.06           |
| <b>Excess return</b>                        | <b>-0.48</b> | <b>0.67</b> | <b>-4.30</b> | <b>4.01</b> | <b>9.63</b> | <b>9.42</b> | <b>8.96</b>    |

\* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

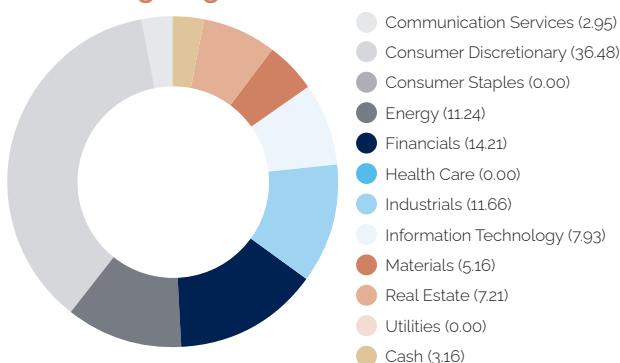
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

Breville Group (BRG)

IPH (IPH)

Tabcorp (TAH)

Source: DNR Capital and Apex Fund Services

## Monthly top contributors and detractors

### Top 3 contributors

Tabcorp (TAH)

Allkem (AKE)

Pinnacle Investment Management (PNI)

### Top 3 detractors

Whitehaven Coal (WHC)

IDP Education (IEL)

ARB (ARB)

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 experienced a decline in May, primarily driven by economic uncertainty and concerns related to the debt ceiling. The market grappled with uncertainties surrounding the US government's ability to meet its financial obligations, which eroded investor confidence. Additionally, the intended consequences of central bank tightening were evident in the form of a slowing economy and weaker economic data. However, there were some positive indicators from stronger payroll reports and wage rises supporting the narrative of a potential soft landing for the economy. Nevertheless, the future path of interest rates and inflation remains uncertain, adding to the overall market volatility.

The prevailing uncertainty in the market is creating attractive opportunities in the small caps sector for long-term focused investors. While near-term volatility is expected to persist, focusing on quality companies better equipped to navigate the current challenges is important. Companies with aligned management teams, adept at allocating capital and boasting strong balance sheets, are likely to emerge from downturns in stronger positions. A number of high-quality companies have experienced a de-rating of valuations in anticipation of potential earnings weakness. Our research efforts continue to focus on ensuring that the structural outlook for our selected companies remains intact. We believe that any cyclical weakness will ultimately prove to be temporary.

The consumer sector has faced challenges recently, with trading conditions deteriorating since April/May. The increased cost of living and higher interest rates have resulted in several earnings downgrades, prompting a wave of selling across the sector. One of our holdings, Lovisa Holdings (LOV), experienced selling pressure following weak trading updates from Universal Store Holdings (UNI) and Michael Hill International (MHJ). This raises concerns about LOV's exposure to the youth and jewellery categories. While near-term trading remains uncertain, particularly as they cycle a strong comparable period of sales, it is important to focus on the long-term opportunities for the business. LOV is embarking on a global store rollout that is still in its early stages. The business model is self-funding and delivers high returns on invested capital. In our view, indiscriminate selling across the consumer space creates attractive opportunities for bottom-up stock picking.

As investors, we constantly ask ourselves what is being priced into current share prices, and where potential mispriced opportunities lie. The market has already begun to incorporate a significant amount of negativity, leading investors to gravitate to the more defensive sectors where valuations appear inflated, as investors seek safety in companies offering more resilient earnings. Conversely, cyclically exposed business

models in sectors like consumer discretionary, financials and industrials have been hit hard over the past year. Against this backdrop, the current market conditions present an opportunity to capitalize on undervalued small-cap stocks within these sectors.

## Performance attribution

### Contributors

- **Tabcorp (TAH):** held its investor day during the month, reiterating its 2025 growth targets. The company is poised to gain significant advantages from regulatory changes, including increased corporate bookmakers taxes. These changes will effectively remove the structural disadvantage TAH faces, enabling them to compete on a level playing field.
- **Allkem (AKE):** announced a merger of equals with Livent, creating a leading global lithium chemicals producer. This strategic move combines diverse assets spanning various jurisdictions, thereby establishing a robust and vertically integrated business model.
- **Pinnacle Investment Management (PNI):** generated net flows of \$1.9bn for the three months to 31 March 2023. Despite the prevailing caution and defensive positioning among institutions, financial advisers, and individual investors, PNI remains well-positioned to capitalize on improved market conditions in the future.

### Detractors

- **Whitehaven Coal (WHC):** recent decline can be attributed to the retracement of thermal coal prices back to their long-run average. WHC has over half its market capitalisation in cash, and the on-market share buy-back continuing, with 18% of its outstanding shares to go.
- **IDP Education (IEL):** was negatively affected when Canada opened up English language testing to competitors, ending IEL's exclusivity for IELTS in Canada. While this announcement had a negative impact, it was not entirely unexpected. Australia and the UK had previously opened up competition and retained market share of 60% and 90%, respectively. In Canada, we anticipate some market share losses for IEL, although the exact magnitude and nature of these losses are uncertain. However, it is worth noting that the market seems to have already priced in a worst-case scenario, assuming a potential 30% drop in volumes into Canada.
- **ARB (ARB):** is experiencing near term disruption in its distribution business in the US following a recent change of ownership. The business continues to win strategic partnerships with key original equipment customers in Australia and internationally, validating the brands strength.

**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.**Disclaimer**

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**Past performance is not indicative of future performance.****Office address**Level 23  
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