

# DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report June 2023

## Performance

The DNR Capital Australian Emerging Companies Fund increased 2.85 % (net of fees) in June, outperforming the S&P/ASX Small Ordinaries Total Return Index by 2.82%.

## Net active return as at 30 June 2023

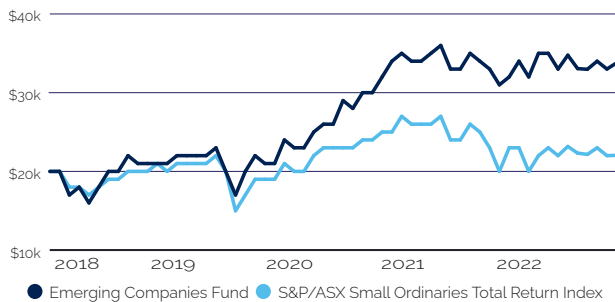
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	4yr p.a. %	Incep.* p.a. %
Emerging Companies Fund	2.85	2.49	1.72	10.60	16.90	12.63	11.46
S&P/ASX Small Ordinaries Total Return Index	0.03	-0.54	1.32	8.45	5.16	2.34	2.03
<b>Excess return</b>	<b>2.82</b>	<b>3.03</b>	<b>0.40</b>	<b>2.15</b>	<b>11.74</b>	<b>10.29</b>	<b>9.43</b>

\* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

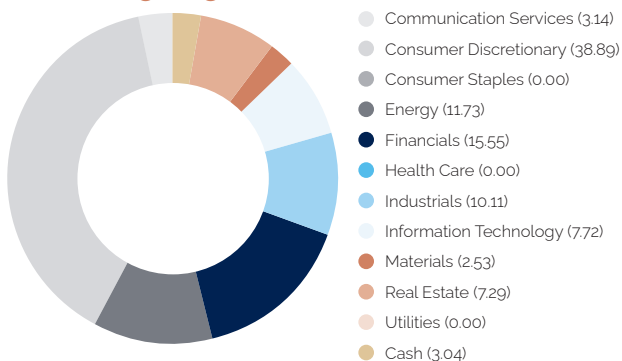
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

Whitehaven Coal (WHC)

Credit Corp (CCP)

Pinnacle Investment Management (PNI)

### Top 3 detractors

Tabcorp (TAH)

Lovisa (LOV)

Paladin Energy (PDN, no holding)

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

For the 2023 financial year, the Fund returned 10.6% (net of fees), outperforming the benchmark's return of 8.4%. Small caps continued to underperform relative to large caps, with the ASX100 returning 15.1% over the last 12 months. This underperformance reflects investor positioning and highlights the potential for mean reversion in small caps once investor confidence improves.

Equities posted strong gains in the face of continued economic uncertainty from higher interest rates and geopolitical tensions. Softer inflation prints, domestically and in the US, suggest we may be closer to a peak in interest rates. Additionally, despite the inverted yield curve signalling a potential recession, economic data continues to demonstrate resilience.

Key contributors to the Fund's performance in June came from positions we have been rebuilding in the hardest hit sectors such as Financials. Credit Corp (CCP) rebounded as we believe shares were already pricing in a recession scenario, trading at its lowest historical valuation range. Pinnacle Investment Management (PNI) outperformed with its suite of active fund managers well positioned to attract flows as conditions improve. Key detractors came from the Consumer Discretionary sector, such as Lovisa Holdings (LOV). This sector appears to be facing the most headwinds from continued cost of living pressures. However, it presents an opportunity for long term investors willing to look through near term volatility. Despite suffering substantial share price declines, the consumer space saw further downward pressure due to sell reports issued by brokerage firms. We maintain our view that the consumer space is starting to throw up attractive opportunities for long-term investors, and we continue to actively seek investments within the sector.

Investing in the consumer space requires a nuanced approach, as not all consumers are alike. Domestically, conditions are challenging due to large household exposure to variable interest rates. However, higher interest rates can be stimulatory for a significant segment of the market that doesn't have a mortgage. In the US, consumers are less affected by higher interest rates due to long-term fixed-rate mortgages. Europe has avoided a recession thus far, as the energy crisis has alleviated pressure on the consumer.

Considering this context, key positions in the Fund are diversified geographically. Breville Group (BRG) generates 80% of its revenue in the US and Europe, Lovisa Holdings (LOV) has 77% of its store network located offshore, and ARB Corporation (ARB) generates 43% of its sales internationally. All these businesses have strong balance sheets, proven management teams, offer a value proposition to its customer, generate high returns, and possess long runways for growth.

While negative headlines dominate, reflecting the challenges faced by consumers and the high risks of recession, we believe that Australia benefits from a range of positive tailwinds in the long term. Notably, the country boasts favourable demographics and enjoys the fastest population growth among developed economies. Moreover, Australia maintains low unemployment rates, decent wage growth, and robust housing fundamentals. Additionally, strong fiscal flexibility at the federal level and ongoing investment in the resources and infrastructure sectors are supporting the economy. It is worth noting that the possibility of a recession is well communicated, and the Reserve Bank of Australia (RBA) possesses significant room for easing interest rates to mitigate the risk and prevent a severe downturn if it were to eventuate.

Valuation dispersion between the market's cheapest and most expensive segments continues to be significant. As the future path of interest rates remains uncertain, there is a possibility that rates could remain higher for an extended period. Consequently, the expensive sectors of the market may face vulnerability. Despite being perceived as defensive, several companies are trading on elevated multiples, providing little margin of safety. Similarly, long duration growth stocks that lack near-term cash flows could also be exposed to risk in this scenario. Conversely, the energy sector remains one of the most affordable sectors in the market. Given its positive fundamentals and trading at discounts to book value, we maintain our exposure to this sector.

Amid significant valuation pullbacks and downward revisions of earnings, investor psychology has turned pessimistic. However, this presents an opportunity for long-term investors, as it increases the odds of higher prospective returns. Unlike 18 months ago, when the Fund's cash weighting was close to 20%, the Fund is now close to fully invested. We are taking a more contrarian approach, focusing on purchasing quality/cyclical stocks in the Consumer, Financial, Technology, and Industrial sectors. Interestingly, many of our recent purchases are companies that we had previously exited, but which now offer significant upside due to the prevailing negativity and recent share price declines. In terms of asset allocation, we have reduced our exposure to Materials as we had been overweight this sector for the past 2-3 years, and our thesis has played out as expected. The demand dynamics are now well understood, and capital has transitioned from being scarce to abundant, leading to an influx of new projects. Consequently, valuations have re-rated significantly, and we now see more attractive returns elsewhere in the market.

## Performance attribution

### Contributors

- **Whitehaven Coal (WHC):** shares rebounded during the month as coal prices stabilised. The share buyback continues, with 91m shares retired out of 240m shares targeted to be bought-back.
- **Credit Corp (CCP):** reconfirmed guidance in May for FY23 NPAT \$90-\$97m. Debt buying remains subdued in Australia/NZ, offset by a more favourable purchasing environment in the US.
- **Pinnacle Investment Management (PNI):** shares rose on the back of equity market gains and affiliate performance.

### Detractors

- **Tabcorp (TAH):** gave back some of the gains from the prior month on limited news flow.
- **Lovisa (LOV):** saw continued selling pressure in June as retail conditions remain difficult.
- **Paladin Energy (PDN, no holding):** rebounded after the Namibian Government clarified comments that it has no intention to seize equity interests in mining and petroleum companies operating in Namibia.

## 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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