DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report July 2023

Performance

The DNR Capital Australian Emerging Companies Fund increased 6.45% (net of fees) in July, outperforming the S&P/ ASX Small Ordinaries Total Return Index by 2.91%. Over the last 12 months, the Fund increased by 11.19%, outperforming the Index by 10.42% (net of fees).

Net active return as at 31 July 2023

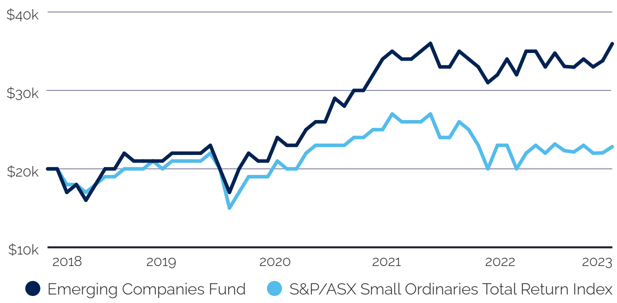
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	4yr p.a. %	Incep.* p.a. %
Emerging Companies Fund	6.45	5.38	3.46	11.19	19.45	14.02	12.68
S&P/ASX Small Ordinaries Total Return Index	3.54	0.20	-1.54	0.77	5.89	2.10	2.72
Excess return	2.91	5.18	5.00	10.42	13.56	11.92	9.96

* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

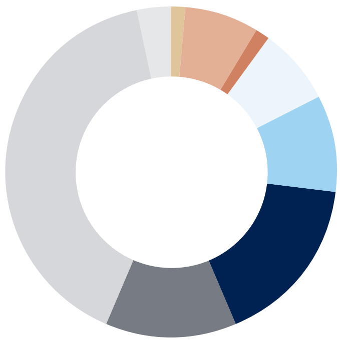
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

Growth of $20,000 since inception



Source: DNR Capital and Apex Fund Services

Sector weightings %



- Communication Services (3.25)
- Consumer Discretionary (40.33)
- Consumer Staples (0.00)
- Energy (12.62)
- Financials (16.73)
- Health Care (0.00)
- Industrials (9.55)
- Information Technology (7.35)
- Materials (1.32)
- Real Estate (7.32)
- Utilities (0.00)
- Cash (1.53)

Source: DNR Capital and Apex Fund Services

Top 3 active holdings (alphabetical order)

Security details
Breville Group (BRG)
IPH (IPH)
Lovisa Holdings (LOV)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors
Credit Corp Group (CCP)
Breville Group (BRG)
Beach Energy (BPT)

Top 3 detractors
Tabcorp Holdings (TAH)
PEXA Group (PXA)
Flight Centre Travel Group (FLT, no holding)

Source: DNR Capital and Apex Fund Services

A team with global experience

Sam Twidale
Portfolio Manager
CFA

Mark Sedawie
Portfolio Manager
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Fund and market review

Equities posted strong gains during July, despite ongoing uncertainty surrounding the outlook for the global economy. Falling inflation is providing optimism that the major central banks could be nearer the end of their tightening cycle, increasing the potential for a soft landing. Although risks around the lagged impact of tighter monetary policy remain, for now, this is being outweighed by a fairly resilient global economy. Unemployment remains low, with household budgets benefiting from higher wages and falling inflation. The positive surprise with falling inflation is that it hasn't been accompanied by a substantial weakening in the labour market, raising hopes that the hard landing scenario expected by many investors over the past year could be avoided.

With elevated cash holdings and generally cautious investor positioning, this positive sentiment saw equity markets recover strongly through July. Small caps marginally outperformed relative to large caps, with the S&P / ASX Small Ordinaries Index increasing 3.5%, versus the ASX 100's 2.8%.

We continue to see the opportunity for further mean reversion over time, especially as investor confidence progressively returns. Small caps have significantly underperformed over the past 18 months, with valuations falling to more attractive levels. However, we note that a selective approach is still required, with pockets of overvaluation persisting; this is especially the case in the defensive sectors and in the more speculative/unprofitable business models across sectors like Health Care, Information Technology, and mining exploration. Once again, this highlights the importance of focusing on quality business models at attractive valuation entry points.

During July, the more cyclical sectors like Financials, Consumer Discretionary, and Energy outperformed the ASX Small Ordinaries Index. In previous months, we have discussed the opportunities emerging in these sectors. Although the near-term outlook remains uncertain, our focus has been on identifying quality business models that have seen share prices and valuations fall to attractive levels. Although the outlook for earnings continues to be challenging in the near-term, the opportunity for long-term focused investors is to identify where this is already being priced in. During July, the Fund's performance benefited from the recovery in several of these holdings bought earlier in the year; including Credit Corp Group (CCP) and Breville Group (BRG), two of the Fund's largest positive contributors to performance during the month.

In reviewing the opportunities across the small cap index in Australia, both the risk and opportunity for investors, we note the significant dispersion in valuations across various sectors of the market.

Given concerns about a slowing global economy, we continue to observe significant crowding in defensive sectors. Although these companies benefit from more resilient earnings streams, many are trading at extremely elevated valuations relative to history. That is, they offer safety in earnings but not necessarily the valuation. These valuations appear even more stretched in the context of the prevailing higher interest rates, highlighting one of the recurring trends in Australian small caps: a short-term bias and a lack of discipline on valuations.

In contrast, we continue to see compelling opportunities emerging in quality business models across sectors like Consumer Discretionary, Financials, and Industrials. Although these companies are facing earnings risks in the near-term, it is because of this uncertainty that shares can now be acquired at attractive entry points. Our focus continues to be on well-managed, high-quality business models with strong balance sheets, positioning them well for when economic conditions eventually improve. Ultimately, valuations are derived based on the long-term cash flows a company will generate, not just over the next 12 months, to which the market can be overly sensitive.

Examples of two de-rated quality opportunities include two of the Fund's key holdings BRG, and Lovisa Holdings (LOV). Both companies are likely to experience weaker conditions in the near-term, as consumer spending slows in response to higher interest rates. However, following significant share price weakness, valuations, and earnings have already started adjusting lower in response to this cyclical weakness. Furthermore, both companies are leaders in their industries, generate high returns, are well managed, and have extremely long runways for long-term growth.

A sector we have continued to use as funding is Materials, which is now the Fund's largest underweight. We believe that the mining cycle has come a long way since we went overweight the sector 2-3 years ago. At the time, valuations were depressed, capital was scarce, and the demand outlook driven by decarbonisation and electric vehicles was not well understood. In contrast to the present, valuations have increased substantially, the demand outlook is well appreciated, and capital is abundant, leading to an influx of new projects. Furthermore, there is now significant execution risk associated with many investments in the sector as management teams attempt to deliver on all the recent project announcements. This was highlighted during the month, with several companies announcing project delays, cost increases and impairments associated with acquisitions or new projects.

Performance attribution

Contributors

- **Credit Corp Group (CCP):** is well positioned to capture debt ledgers in an improving environment, benefiting from increased supply and improved prices.
- **Breville Group (BRG):** shares rose on the back of trading updates from peers highlighting resilient demand in the end consumer, particularly the coffee category.
- **Beach Energy (BPT):** produced a solid 4Q23 report with production up 12% to 5m barrels of oil and revenue up 27% to $450m. Progress continues on its major growth projects, with further updates expected at the August result.

Detractors

- **Tabcorp Holdings (TAB):** shares fell as peer results highlighted softening wagering conditions.
- **PEXA Group (PXA):** shares lagged the benchmark despite improving property market fundamentals and regulatory delays impacting interoperability.
- **Flight Centre Travel Group (FLT, no holding):** shares rose, impacting the Fund's relative performance, as the travel company updated its profit guidance to reflect buoyant travel conditions.

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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