

# DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report August 2023

## Performance

The DNR Capital Australian Emerging Companies Fund decreased -3.24% (net of fees) in August, underperforming the S&P/ASX Small Ordinaries Total Return Index by -1.93%. Over the last 12 months, the Fund increased by 1.01%, outperforming the Index by 2.13% (net of fees).

## Net active return as at 31 August 2023

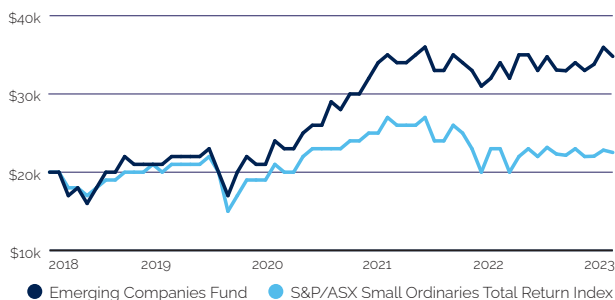
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
Emerging Companies Fund	-3.24	5.92	5.26	1.01	13.61	11.71	11.71
S&P/ASX Small Ordinaries Total Return Index	-1.31	2.22	0.90	-1.12	3.00	2.40	2.40
<b>Excess return</b>	<b>-1.93</b>	<b>3.70</b>	<b>4.36</b>	<b>2.13</b>	<b>10.61</b>	<b>9.31</b>	<b>9.31</b>

\* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

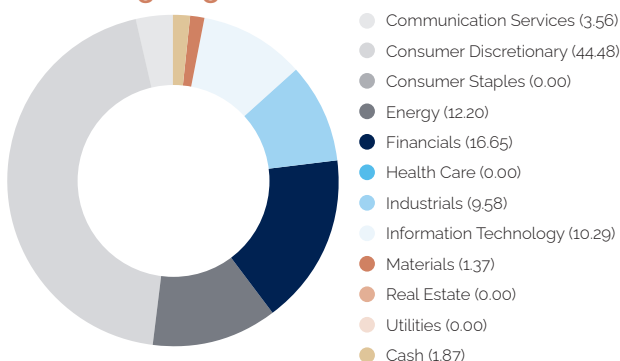
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

ARB Corporation (ARB)

Breville Group (BRG)

Lovisa Holdings (LOV)

Source: DNR Capital and Apex Fund Services

## Monthly top contributors and detractors

### Top 3 contributors

Breville Group (BRG)

ARB Corporation (ARB)

Tabcorp Holdings (TAH)

### Top 3 detractors

IRESS (IRE)

Credit Corp Group (CCP)

Pinnacle Investment Management Group (PNI)

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 volatile month during the August reporting season, with outsized share price moves as investors reacted to a mixed set of earnings announcements. Contributing to this volatility was a market characterised by significant dispersion in valuations, earnings expectations, and sentiment, as investors continue to deal with a highly uncertain macro environment. It was surprising to see the extent of the outperformance of many growth-focused companies in the Index where the Fund is underweight, with valuations for a number of barely profitable companies reaching extremely elevated levels. The lack of valuation discipline creeping into some sectors of the market also seems at odds with the current higher interest rate environment.

Key positive contributors during the month came from holdings in the Consumer Discretionary sector including Breville Group (BRG), ARB Corporation (ARB), Lovisa Holdings (LOV) and Tabcorp Holdings (TAH). With many consumer companies selling off earlier in the year, and investors cautiously positioned, these companies recovered following better than feared earnings releases. The main disappointment during the month was Iress (IRE), which explains all the Fund's underperformance versus the Index. Its shares fell sharply following weaker earnings guidance, with the restructuring being undertaken by new management weighing on profitability more than we had anticipated in the short-term. We discuss IRE in further detail below.

Financials sector holdings like Credit Corp Group (CCP) and Pinnacle Investment Management Group (PNI) also detracted from the Fund's performance, giving back some of the prior month's strong gains.

Reviewing reporting season overall there were several key takeaways. Firstly, despite concerns around the outlook for the global economy, consumer exposed companies were some of the strongest performers during the month. Demand has generally proven to be more resilient than feared, with results coming in ahead of conservative expectations. There are also signs of inflationary pressures starting to ease, with several companies highlighting the early signs of falling raw material costs and lower freight rates. In recent months, we have been highlighting the opportunities emerging in the Consumer Discretionary sector. Share prices have fallen significantly, valuations have de-rated, and earnings are being downgraded, offering compelling entry points for quality businesses with attractive long-term outlooks. The fact that inflationary pressures are easing is also positive, as this suggests that risks to margins have started to stabilise.

One such opportunity in the Fund is BRG. Despite uncertainties in the near-term environment, the FY23 results underscored the company's ability to sustain margins while reinvesting back into the business. Management's focus on research and development is

resulting in a healthy pipeline of new products, which will help to drive sales growth in the coming years. In the structurally growing coffee category, the company is building strong market leadership globally with a range of premium coffee machines. Geographical expansion is also firmly on the company's agenda, with a particular focus on Asia, commencing with the South Korean market. We believe that BRG is a great example of a business building economies of scale, allowing it to further reinvest and strengthen its market position over time.

Some of the challenges facing the mining sector were evident during the recent reporting season. Mining is a sector we have become more cautious on in recent months, with the latest reporting season highlighting some of our concerns. This includes the challenges associated with delivering a significant pipeline of new projects at a time of labour shortages, capital cost inflation and falling revenue due to weaker commodity prices. We expect this challenging outlook could continue. A significant amount of capital has come into the sector in recent years, especially in commodities exposed to decarbonisation like lithium. This is set to result in supply expanding materially in the coming years. We also believe that industry forecasts around decarbonisation may prove too optimistic in the short to medium-term, leading to lower demand forecasts.

IRE was the main disappointment for the Fund during reporting season, with its shares falling significantly after downgrading earnings guidance. Following mismanagement and suboptimal capital allocation decisions by the previous management team, the new management team is looking to turn the business around with a private equity style mindset. The new strategy is to reinvest in the core wealth management business which has been neglected, and to exit non-core assets which are diluting returns. Management has already sold MFA for \$52m and is on-track to divest the platform business, with proceeds from both sales being used to de-lever the balance sheet. The company is also exploring other non-core asset sales such as mortgages and UK wealth. The business generates over \$600m in revenues yet has a cost base close to \$500m. We believe there is ample opportunity to right-size the business and achieve similar margins and returns profile that align favourably with those of its publicly listed peers. Transformations are rarely linear, and we have used the share price weakness to add to the portfolios position. If management can execute on its strategy, we see material upside to the current share price, with the shares now trading on the lowest price to sales multiple since its IPO in 2001 (1.9x sales).

We continue to look for strong bottom-up investment opportunities, in quality companies trading at attractive valuations. Key positions are currently across the Consumer Discretionary, Financials, Industrials, Technology and Energy sectors. The short-term bias of many investors is resulting in a range of de-rated quality

opportunities, especially in companies experiencing some uncertainty in the short-term, yet where the long-term outlook remains attractive. We believe that taking a longer-term view on these opportunities will be rewarded, especially once the uncertainty around the outlook for the economy and earnings improves.

### Performance attribution

#### Contributors

- **Breville Group (BRG):** delivered 10% EBIT growth, coming in at the top end of management guidance. The company enters FY24 in a solid position with a pipeline of new products, further geographic expansion and moderating cost pressures.
- **ARB Corporation (ARB):** is on track to grow profits in FY24 given ongoing strong demand, new products and improving margins as input cost pressures ease.
- **Tabcorp Holdings (TAH):** delivered a strong FY23 result driven by lower operating expenses. TAH's revamped digital offering is gaining traction and regulatory changes to level the playing field should result in a more rational and competitive environment.

#### Detractors

- **IRESS (IRE):** delivered a disappointing 1H23 result, reducing FY23 earnings guidance due to cost headwinds and reduced market trading volumes. While the transformation remains on track, the company is incurring higher costs in the near term as it implements the cost out program.
- **Credit Corp Group (CCP):** gave a cautious outlook statement given the uncertain economic outlook. CCP is well positioned to capitalise on the increased debt supply in the US at more favourable prices.
- **Pinnacle Investment Management Group (PNI):** results have been impacted by volatile equity markets but it remains well positioned to capitalise on fund flows as investor confidence improves.

### 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.

**Target market:** The DNR Capital Australian Emerging Companies Fund is an actively managed fund that offers investors exposure to a concentrated portfolio of high quality, small cap Australian listed equities. This product is likely to be appropriate for a consumer seeking capital growth to be used within an investment portfolio where the consumer has a medium or long investment timeframe, high or very high risk/return profile and needs daily access to capital.

### 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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