

DNR Capital Australian Emerging Companies Fund

APIR code: PIM4357AU

Performance Report September 2023

Performance

The DNR Capital Australian Emerging Companies Fund decreased -5.14% (net of fees) in September, underperforming the S&P/ASX Small Ordinaries Total Return Index by -1.10%. Since inception, the Fund increased by 10.36% p.a., outperforming the Index by 8.83% p.a. (net of fees).

Net active return as at 30 September 2023

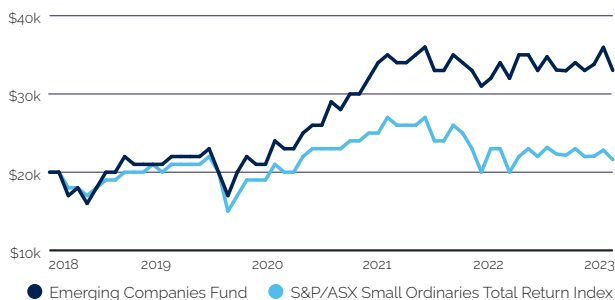
	1mth %	3mth %	6mth %	1yr %	3yr p.a. %	5yr p.a. %	Incep.* p.a. %
Emerging Companies Fund	-5.14	-2.30	0.13	2.17	12.85	10.50	10.36
S&P/ASX Small Ordinaries Total Return Index	-4.04	-1.94	-2.47	6.85	2.57	1.63	1.53
Excess return	-1.10	-0.36	2.60	-4.68	10.28	8.87	8.83

* Inception Date—August 2018

Source: DNR Capital and Apex Fund Services

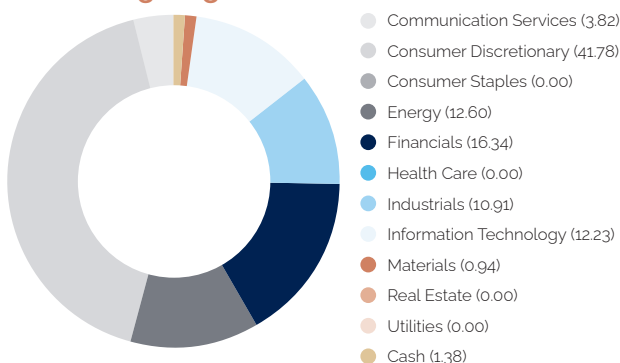
Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made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

IPH (IPH)

Source: DNR Capital and Apex Fund Services

Monthly top contributors and detractors

Top 3 contributors

Whitehaven Coal (WHC)

Beach Energy (BPT)

Leo Lithium (LLL, no holding)

Top 3 detractors

Tabcorp Holdings (TAH)

Lovisa Holdings (LOV)

Breville Group (BRG)

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

Equity markets declined through September, primarily due to the surge in global bond yields. Over the past few months, long-term bond yields have seen a significant rise, reaching new cycle highs. For instance, the 10-year government bond yield in Australia has now surpassed 4.5%, driven by the aggressive tightening of monetary policy by the major central banks. Persistent high inflation due to a robust economy and rising oil prices has also led central banks to signal that interest rates are likely to remain "higher for longer." This scenario presents a more challenging environment for equity markets, with concerns surrounding the potential effects of elevated bond yields on global growth.

In September, rising bond yields posed challenges to market valuations, particularly affecting longer-duration growth stocks, which generally underperformed value sectors. This impacted the Fund's holdings in the Consumer Discretionary sector, which contributed to the underperformance versus the index during the month. This included holdings like Tabcorp Holdings (TAH), Lovisa Holdings (LOV) and Breville Group (BRG), which saw share price declines of 10% or more during the month. Despite the uncertain earnings outlook in the short-term, we continue to see considerable long-term value in these opportunities, with valuations and earnings expectations having significantly rebased lower over the past year.

The Energy sector was one of the few sectors that outperformed the Index during the month, benefiting from higher oil prices driven by constrained supply and resilient demand. This saw the Fund's holdings in Whitehaven Coal (WHC) and Beach Energy (BPT) outperform during the month, with both companies rebounding from depressed valuations. We continue to see attractive opportunities across the Energy sector, with the market too pessimistic on the outlook in our view. The transition towards renewable energy is likely to take many decades given the cost and technological constraints involved, with traditional energy still necessary during this transition period. Despite this resilient demand outlook, investment in new supply has been curtailed in recent years, resulting in tight markets for traditional energy commodities.

We believe that the Australian small-cap sector is currently offering compelling opportunities for long-term investors who are willing to look beyond the near-term uncertainty. Following the recent sell-off, this sector has underperformed large caps by nearly 20% over the past two years. Valuations have also declined, with many high-quality small-cap stocks now trading at significant discounts relative to comparable large-cap stocks, despite what we see as their superior medium to long-term growth potential. Earnings expectations have also adjusted downward, with the forward earnings per share (EPS) for the index now below pre-COVID-19 levels, following a recent 15% aggregate downgrade. This is a stark departure from the scenario of two years ago when valuations and earnings were at peak levels, often described as 'priced for perfection'.

There is clearly considerable uncertainty and debate around the outlook for the economy, interest rates and inflation. However, one of the attractions of investing in the small cap sector is the opportunity to identify strong bottom-up investment ideas, especially in companies more in charge of their own destiny. Clearly few companies are entirely immune from the macroeconomic backdrop. Nevertheless, even in a cyclical sector like Consumer Discretionary, we are invested in companies with clear organic growth led strategies. Here, management teams are reinvesting in new product innovation, further geographic expansion, or capacity expansion, with the expectation of driving significant growth in earnings over the medium to long-term. When the market presents opportunities to acquire these companies at discounted prices due to near-term cyclical concerns, we believe it's the time for the patient long-term investors to step-in and take advantage. We would highlight the Fund's positions in BRG, LOV and ARB Corporation (ARB) as examples of these types of opportunities.

We continue to focus on strong bottom-up investment opportunities in high-quality companies trading at attractive valuations. Currently, our key positions are spread across various sectors, including Consumer Discretionary, Financials, Industrials, Technology, and Energy. When we review the characteristics of the DNR Capital Australian Emerging Companies Fund, we observe that the forward Price-to-Earnings (PE) multiple is currently one of the lowest since the Fund's inception, standing at 16x. Additionally, the average Return on Equity (ROE) is at its highest since the Fund's inception, reaching 29%. This ROE significantly surpasses the index's level of 10%. Furthermore, the Fund's balance sheet leverage is notably lower than that of the index, with the Fund's average Net Debt / EBITDA multiple at 0.5x compared to the index's 1.0x. These characteristics reflect our approach to the current market, where we aim to focus the portfolio on businesses with attractive pricing models and superior quality attributes compared to the index.

Performance attribution

Contributors

- **Whitehaven Coal (WHC):** confirmed its participation in the sale process initiated by BHP in relation to the Daunia and Blackwater metallurgical coal mines in Queensland.
- **Beach Energy (BPT):** benefited from rising oil prices following recent output cuts by Saudi Arabia and Russia.
- **Leo Lithium (LLL, no holding):** shares fell after the Government of Mali suspended its mining operations.

Detractors

- **Tabcorp Holdings (TAH):** pulled back despite reporting a solid result the previous month with market share stabilising and good cost control.
- **Lovisa Holdings (LOV):** pulled back as the market remains cautious on consumer exposed stocks given the uncertain economic environment.
- **Breville Group (BRG):** pulled back as the market remains cautious on consumer exposed stocks given the uncertain economic environment.

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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