# DNR Capital Australian Emerging Companies Fund

## Performance Report – April 2021

### Performance

The DNR Capital Australian Emerging Companies Fund increased 4.90% (net of fees) in April, broadly in line with the S&P/ASX Small Ordinaries Accumulation Index which increased 4.98%. Over the last 12 months the Fund increased by 49.29%, outperforming the Index by 9.51% (net of fees).

### Market review

April was another strong month for equities, with investors focusing on the prospect of a strong recovery from the coronavirus pandemic. The more advanced vaccination programmes are showing promising signs, with new COVID-19 cases falling sharply in countries like the UK and the US. In addition, significant pent-up demand, increased fiscal spending, and loose monetary policy will all provide a significant boost to the global economy over coming quarters. Given the lessons learnt following the GFC when a number of economies suffered double-dip recessions and anaemic growth, there appears limited appetite to tighten policy too prematurely. This is providing a supportive environment for equities and general risk appetite levels.

Given this backdrop, many of the more cyclical sectors of the market performed strongly during April. Of the Fund's holdings, this included companies exposed to housing like Reece (REH), a leading supplier of bathroom and plumbing products, and the online real estate company Domain Holdings Australia (DHG). Commodity prices also strengthened further, benefiting holdings in the Materials sector like IGO (IGO) and Orocobre (ORE) who are exposed to growth in renewables investment and electric vehicles. The Materials sector remains a core overweight, with higher commodity prices underpinned by tight supply and improving demand. Within the sector, we prefer strong bottom-up opportunities where management is focused on creating value for shareholders. For example, IGO is transforming into a leading producer of commodities exposed to battery materials, acquiring lithium assets at the bottom of the cycle, and selling its gold assets towards the top of the cycle. ORE is also gaining significant scale and diversification benefits via its recently announced merger with Galaxy Resources (GXY).

Despite the positive progress with vaccines, there clearly remains uncertainty surrounding the impact of COVID-19 in the short term, especially in the emerging economies like India where the outlook has deteriorated in recent weeks. As a result, several of the Fund's reopening opportunities underperformed during April, like IDP Education (IEL) and Corporate Travel Management (CTD). We continue to focus on the long-term outlook, with both companies set to take significant market share during the recovery given the opportunistic investments made during the downturn.

During the month the market rotated back into some of the more growth-orientated companies, many of which sharply underperformed during the recent value rotation. We have been selectively adding to opportunities in this part of the market, especially those high-quality business models with positive long-term outlooks.

### Fund overview

| | |
|---|---|
| APIR Code | PIM4357AU |
| Investment bias | Style neutral with a quality focus |
| Designed for | The Fund is designed for investors seeking a medium-longer term investment focused on achieving growth, with less focus on generating excess income. The investor is prepared to accept higher volatility in pursuit of higher growth. |
| Investment objective | The Fund's investment objective is to invest in a portfolio of Australian emerging companies that aims to outperform the Benchmark (net of fees) over a rolling five-year period. The investment objective is not a forecast of the Fund's performance. |
| Benchmark | ASX/S&P Small Ordinaries Accumulation Index |
| Investable universe | Australian equities and cash |
| Investment constraints | The Fund will not invest in derivatives |
| Investment guidelines | Maximum exposure to an individual security is 15% of Fund NAV |
| Asset allocation | Australian Equities - 80-100% |
| | Cash - 0-20% |
| Risk level | High |
| Number of securities | Min 20 - max 45 |
| Minimum suggested investment timeframe | 5 years |
| Buy/sell spread | +0.30% / -0.30% |
| Management fee | 1.15% p.a. of the NAV of the Fund (inclusive GST and RITC) |
| Performance fee | 20% of outperformance of the Fund relative to the Fund's Benchmark (after the management fee) |
| Minimum initial application amount | $20,000 |
| Minimum further application amount | $5,000 |
| Minimum withdrawal amount | $5,000 |
| 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 |
| Entry/exit fees | Nil |

## Net active return as at 30 April 2021

| | 1mth % | 3mth % | 6mth % | 1yr % | 2yr % | Incep.* % |
|---|---|---|---|---|---|---|
| Emerging Companies Fund | 4.90 | 12.85 | 32.04 | 49.29 | 17.68 | 16.18 |
| S&P/ASX Small Ordinaries Accumulation Index | 4.98 | 7.44 | 21.44 | 39.78 | 10.08 | 7.79 |
| **Excess return** | **-0.08** | **5.41** | **10.60** | **9.51** | **7.60** | **8.39** |

** Inception Date—August 2018*
*Source: Mainstream Fund Services and DNR Capital*

*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 fees or taxation.*

For example, we recently added to the Fund's holdings in Breville Group (BRG), with the shares having fallen nearly 20% since the positive update in February. However we remain cautious on those areas of extreme valuation, with many of the secular growth stocks still on elevated valuations and with optimistic earnings forecasts. The recent collapse in a number of technology and online companies like Nuix (NXL), Appen (APX) and Adore Beauty Group (ABY) supports our cautious stance on this part of the market.

A key risk surrounding the market outlook is a pickup in inflation, especially given the unprecedented scale of the stimulus measures. A number of companies are already warning of increased inflationary pressures, which we expect to build further as the global economy recovers and capacity utilisation tightens. The sharp increase in commodity prices over the last 12 months highlights the pressures building, with supply chain constraints across several industries adding to this. In our view, this highlights the importance of focusing on a company's quality business model that allows it to raise prices as necessary given its strong industry position. It also supports the Fund's overweight in the Materials sector, which has historically been one of the key beneficiaries of a more inflationary environment.

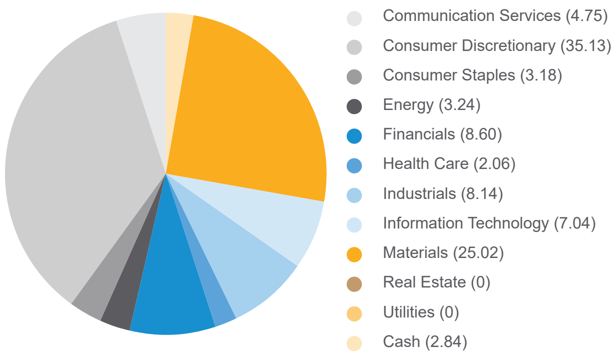
Overall, the Fund is positioned across a broad range of opportunities, including the more cyclical areas of the market like resources and consumer discretionary, reopening stocks that will benefit from a normalisation of the pandemic, and quality growth stocks that we believe are attractively priced. Although the macroeconomic outlook is receiving a lot of attention given the debate around inflation/deflation and the direction of bond yields, we continue to search for strong bottom-up opportunities, with a preference for companies that can deliver value for shareholders regardless of the prevailing economic environment.

## Top 5 active holdings (alphabetical order)

| |
|---|
| IDP Education |
| IGO |
| Iluka Resources |
| Lovisa Holdings |
| Lynas Corporation |

*Source: Mainstream Fund Services and DNR Capital*

## Sector weightings %




*Source: DNR Capital*

## Monthly - top contributors and detractors

| **Top 3 contributors** |
|---|
| IGO |
| Domain Holdings Australia |
| Reece |

| **Top 3 detractors** |
|---|
| Whitehaven Coal |
| Lynas Rare Earths |
| Credit Corp Group |

** Alpha is the fund return less benchmark return. These tables represent the stocks contribution of alpha to overall fund alpha and is determined by the stocks active weight relative to the benchmark and share price return relative to the benchmark.*

## Attribution

The key stocks contributing to the Fund's monthly relative performance include:

**Contributors**

- **IGO (IGO):** Finalised the sale of its 30% interest in the Tropicana gold mine. The $900m sale price to Regis Resources was above consensus estimates leaving IGO well capitalised in a net cash position. This takes the company one step closer to be becoming a pure-play raw material stock for the electric vehicle and renewable energy industries, with regulatory approvals for the Tianqi lithium acquisition expected to close this quarter.

- **Domain Holdings Australia (DHG):** Shares rebounded as improving property market conditions lead to increased listing activity. After leaving prices unchanged at the start of the year, DHG is proposing an out-of-cycle price rise on July 1 (alongside peer realestate.com.au).
- **Reece (REH):** Is experiencing favourable conditions in its key markets. Strong construction and DIY activity is supporting strong demand for REH's plumbing products. It is a high-quality business, with a strong record of growth led by an aligned management team. We expect REH to emulate its Australian success in the US market following its acquisition of Morsco in 2018.

**Detractors**

- **Whitehaven Coal (WHC):** Announced technical difficulties at its Narrabri coal mine leading to group production downgrades of 4%. While it is disappointing that WHC was unable to fully leverage the spike in coal prices, the shares look dramatically oversold with the market effectively valuing Narrabri at zero.
- **Lynas Rare Earths (LYC):** Shares consolidated during the month after recent outperformance. LYC announced its third quarter results with favourable market conditions leading to strong rare earths prices. Cash collections were strong at $133m in the quarter, leaving the company in a strong financial position with $569m cash on the balance sheet.
- **Credit Corp Group (CCP):** Shares fell despite reconfirming guidance for a strong FY21 result. Debt buying volumes are depressed near term as stimulus and forbearances are resulting in less debt charge-offs. This has the potential to weigh on future cash collections. The business is well managed with substantial capacity (over $400m) to increase investments as opportunities arise, particularly in the US market.

## Investment strategy

DNR Capital's security selection process has a strong bottom-up discipline and focuses on buying quality emerging businesses at reasonable prices. The process involves comprehensive company and industry research, company visits and meetings, and detailed valuation analysis and modelling. This information is used to assess the quality of a business, and the expected return.

The portfolio construction process considers stock weightings based on the risk versus the expected return. It is also influenced by a top-down economic appraisal, sector exposures and liquidity considerations.

The investment strategy of the Fund is intended to result in a concentrated portfolio that is high conviction and invests for the medium to long-term.

## Investment philosophy

DNR Capital believes a focus on quality will enhance returns when combined with a thorough valuation overlay. DNR Capital seeks to identify good quality emerging businesses that are mispriced by overlaying DNR Capital's quality filter, referred to as the 'quality web', with a strong valuation discipline.

## Platform access

- BT Panorama
- BT Wrap
- HUB24
- Macquarie Wrap
- Netwealth
- Praemium

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