

DNR Capital Australian Equities Income Portfolio

Performance Report August 2023

Performance

The DNR Capital Australian Equities Income Portfolio outperformed the S&P/ASX 200 Industrials Total Return Index by 0.24% in August. The Portfolio's dividend yield expectation for 2023 is currently 4.99% (6.60% grossed up for franking credits).

Gross active return as at 31 August 2023

	1mth %	3mth %	1yr %	3yr p.a. %	5yr p.a. %	7yr p.a. %	10yr p.a. %	15yr p.a. %	Incep. ¹ p.a. %
Income Portfolio	-0.08	1.99	6.56	14.91	8.60	9.12	10.13	9.99	8.12
S&P/ASX 200 Industrials Total Return Index	-0.32	3.52	6.70	8.93	5.29	6.72	7.61	7.90	5.63
Excess return	0.24	-1.53	-0.14	5.98	3.31	2.40	2.52	2.09	2.49
Income Portfolio dividend yield incl. franking credits¹	1.03	1.11	7.00	7.46	6.50	7.11	8.15	8.92	7.42
Franking %	46.84	43.79	75.54	75.10	74.91	74.27	73.11	71.95	71.74

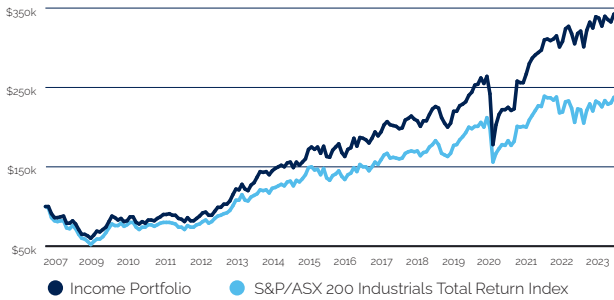
¹Inception date—December 2007.

Source: DNR Capital

¹ Portfolio income yield calculated as the sum of all income received over the period divided by the capital base at the start of the period and uses income sources ex-date (including franking credits).

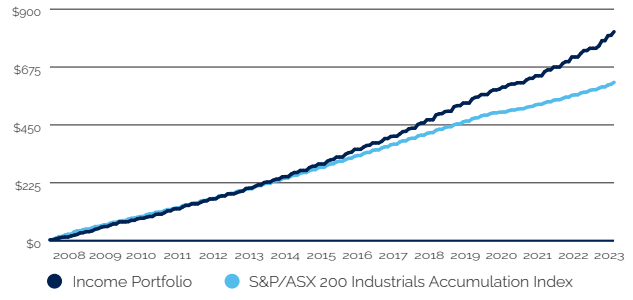
Performance data relates to the DNR Capital model Portfolio Performance of an investment in this model portfolio through a Portfolio Service may have different performance to the performance in this monthly update as a result of different policies and procedures at different Portfolio Service operators. Past performance is not an indication of future performance. No allowance has been made for taxation and fees are not taken into account.

Growth of \$100,000 since inception



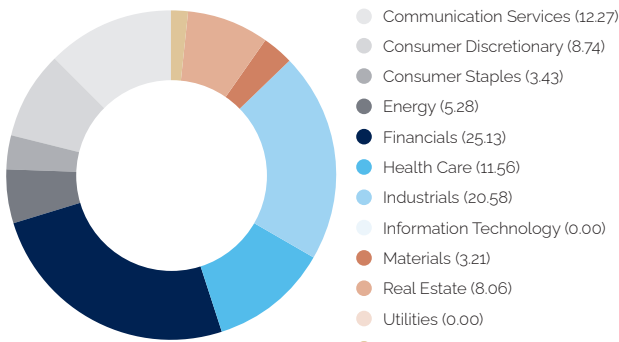
Source: DNR Capital

Accumulated income from \$1,000 since inception



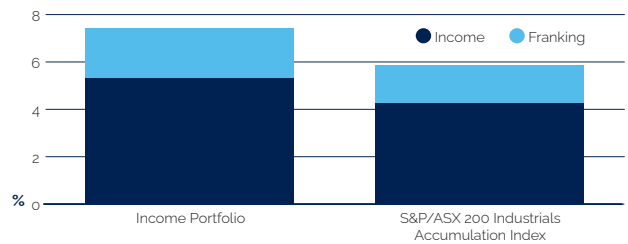
Source: DNR Capital

Sector weightings %



Source: DNR Capital

Income yield incl. franking credits since inception



Source: DNR Capital

Experienced portfolio managers



Top 5 active holdings

Security details

CSL
National Australia Bank
ANZ Group Holdings
Telstra Group
QBE Insurance Group

Monthly top contributors and detractors

Top 3 contributors		Alpha*
TPG Telecom	Overweight	0.48
Domino's Pizza Enterprises	Overweight	0.22
Transurban Group	No holding	0.20

Top 3 detractors

Wesfarmers	No holding	-0.37
Goodman	No holding	-0.31
Endeavour Group	Overweight	-0.24

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

Contributors

- **TPG Telecom (TPG):** received an offer from Vocus Group to acquire its enterprise, government and wholesale assets (including associated infrastructure) for ~\$6.3bn (based on a provisional earnings before interest, taxes, depreciation and amortisation (EBITDA) of \$550m). The bid whilst indicative, highly conditional and non-binding highlighted the underlying value of the stock to investors.
- **Domino's Pizza Enterprises (DMP):** outperformed following its FY23 result which missed expectations but provided trading updates with positive momentum in key Australian, NZ and European markets. Asian markets remain challenged but group restructuring, and declining cost of good sold (COGS) headwinds provides a more constructive outlook.
- **Transurban (TCL, no holding):** higher interest rates remain an earnings and valuation headwind for bond proxies like TCL. FY24 DPS guidance was broadly in-line with expectations, however included an asset cash release rather than being funded by operating cash flows.

Detractors

- **Wesfarmers (WES, no holding):** outperformed with the group's FY23 earnings exceeding expectations and showing resilient earnings in a tougher retail background with Bunnings and Kmart continuing to drive consumers into store through value and range.
- **Goodman (GMG, no holding):** outperformed during the period, following the delivery of an in-line result and an optimistic full-year earnings presentation. While tightness in the industrial asset segment appears to be easing, GMG believes that a substantial portion of its development sites could

serve as data centres. The market appears to be ascribing additional value to this proposition given a broader bullishness surrounding the opportunity for artificial intelligence (AI).

- **Endeavour Group (EDV):** underperformed following a good operating result, but a surprising deterioration in its balance sheet from working capital, tax and capital expenditure due to significantly higher than anticipated interest costs.

Portfolio and market review

The S&P/ASX 200 Total Industrial Return Index was down 0.32% during the period. Consumer Discretionary (+4.6%) was the best performing sector, following strong annual results from Wesfarmers (WES +8.5%) and Domino's Pizza Enterprises (DMP +10.1%). A-REITs (+2.3%) also outperformed, with Goodman (GMG +13.7%) reporting solidly and indicating that its industrial asset pipeline will likely support a substantial move into data centres. Utilities (-4.3%) was the worst performing sector, with AGL Energy (AGL -9.0%) unable to sustain its momentum on the back of higher electricity prices. Consumer Staples (-4.1%) also underperformed, as grocer Coles Group (-10.6%) underwhelmed in its annual report to shareholders, seeing a need for increased capital expenditure (capex) to return to similar levels of operational efficiency as peers.

The DNR Capital Australian Equities Income Portfolio outperformed its benchmark for the period. Key stock contributors were TPG Telecom (TPG), DMP and Transurban Group (TCL) (no holding). Key stock detractors were WES (no holding), GMG (no holding) and Endeavour Group (EDV). The Portfolio's dividend yield expectation for CY2023 is currently 4.99% (6.60% grossed up for franking credits).

Reporting season takeaways

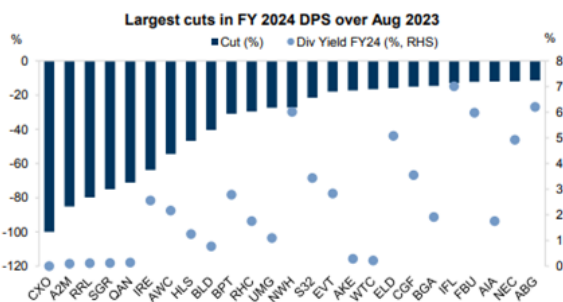
A decent reporting season illustrated the underlying strength of the domestic economy, increased migration and low unemployment. However, this was offset by cautious outlook commentary driven by slowing growth and the ongoing impact of the Reserve Bank of Australia (RBA) hikes.

Key themes

- **Revenue beats:** sales tended to beat expectations, albeit this was primarily driven by price as inflationary pressures are being largely passed on to customers.
- **Offset by higher costs:** escalating costs, particularly labour, rent, energy & transport costs remain a consistent theme. Price increases and targeted cost out remain key avenues to offset these pressures. Higher capital expenditure (capex) was also a key pressure point, once again highlighting that inflationary pressures remain.
- **And higher interest costs:** the impact of rising interest costs finally emerged throughout reporting season, with higher-than-expected interest costs being a key contributor to earnings downgrades.

- **Consumer pressure emerging:** the rising cost of living and the impact of higher mortgage rates are starting to weigh on consumer spending. Consumers overall are downbeat, albeit primarily in younger households and mortgagees, whilst retirees have increased savings and are spending more.
- **Guidance / outlook is cautious:** the economy remains resilient, so it is difficult to assess whether FY24 guidance will prove conservative or if risk remains to the downside.
- **Earnings and dividends were downgraded:** the level of volatility across the portfolio and market was particularly high during the reporting season period this month, with a number of outsized moves relative to the earnings per share (EPS) revisions. 12-month forward EPS was revised down -2%, whilst DPS expectations fell -3%. Fortunately, the portfolio avoided many of the large dividend cuts that occurred during the month.

ASX 200 stocks with the largest FY24 dividend cuts over August



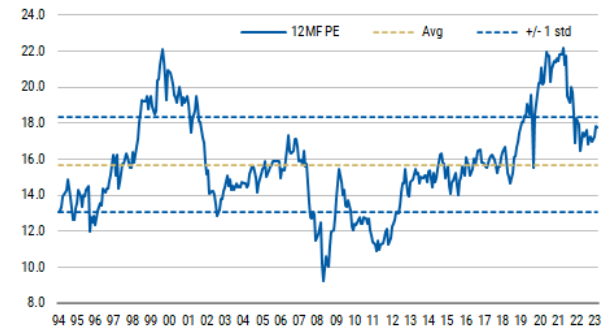
Source: FactSet, Goldman Sachs Global Investment Research

What have we been doing?

Being defensively positioned has been somewhat painful over the last 12 months, however we believe that markets are optimistically pricing the Goldilocks scenario whilst being complacent about key challenges, which include: 1) the full impact of interest rate hikes are yet to be seen; 2) persistent inflation; 3) China's economic recovery has been underwhelming; 4) artificial intelligence (AI) mania has prompted a significant rally in the "Magnificent 7" that has distorted valuations; and 5) ongoing geopolitical risk.

The S&P ASX200 Industrials Total Return Index is currently trading at 12-month forward price to earnings ratio (PE) of ~18x, which remains elevated relative to history.

ASX200 Industrials Index 12-months forward PE



Source: Morgan Stanley

During the month, we added to existing portfolio positions in resilient quality companies that have recently underperformed the market despite delivering operationally good results and presenting good value on risk-reward metrics. These include Auckland International Airport (AIA), Amcor Plc (AMC), CSL (CSL), Endeavour Group (EDV), IPH (IPH), Qube Holdings (QUB), Telstra Group (TLS) and The Lottery Corporation (TLC).

About DNR Capital and the Portfolio

Concentrated: Investing in 15-30 highest conviction, Australian listed equities. Concentrated portfolios of quality companies maximise the opportunity for outperformance.

Style neutral and quality focussed: A disciplined approach to quality and valuation.

Dual investment objective: Acknowledging the value of both income and capital, this strategy focuses on delivering a high level of tax effective income, that grows over time, in addition to growing the investors capital.

A diversified set of opportunities: At DNR Capital, we categorise income generating companies as:

- **Growers:** A company that is delivering below market income in the short term, however is expected to deliver above market income growth over the long term.
- **Compounders:** A company that is delivering a market level of income, with the potential to deliver above market income growth on a sustainable basis.
- **Cows:** A company with a solid balance sheet and capital management potential that is being undervalued on traditional earnings-based metrics.
- **Yielders:** A company that is delivering sustainable and cash-backed dividends, however with minimal (or no) income growth.

Experienced and aligned team: The portfolio managers have more than 45 years of combined investment experience and are invested alongside our clients.

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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